



Scottish Law Commission  
*promoting law reform*

(DISCUSSION

129)

# Discussion Paper on Variation and Termination of Trusts

discussion  
paper





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December 2005

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The Honourable Lord Eassie, *Chairman*  
Professor Gerard Maher, QC  
Professor Kenneth G C Reid, CBE  
Professor Joseph M Thomson  
Mr Colin J Tyre, QC.

The Chief Executive of the Commission is Mr Michael Lugton. Its offices are at 140 Causewayside, Edinburgh EH9 1PR.

**The Commission would be grateful if comments on this Discussion Paper were submitted by 17 March 2006.** 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:

Dr David Nichols  
Scottish Law Commission  
140 Causewayside  
Edinburgh EH9 1PR

Tel: 0131 668 2131  
Fax: 0131 662 4900  
Email: [info@scotlawcom.gov.uk](mailto:info@scotlawcom.gov.uk)

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

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# SUMMARY

1. This discussion paper puts forward proposals for the reform of trust law in three main areas:

- Variation or termination of private trusts by agreement of the beneficiaries.
- Variation or termination of private trusts by the courts.
- Variation or termination of non-charitable public trusts by the courts, public authorities or the trustees.

## **Variation or termination by beneficiaries**

2. Under the existing law in Scotland where all the beneficiaries of a private trust are of full age (18 or over) and capacity they can agree to terminate the trust unless there are trust purposes that require its continuation. They can also all agree to vary the trust although there is little direct case-law authority for this. The termination or variation may be carried out whether or not the truster approves.

3. Some other jurisdictions, such as many states in the USA, prevent variation or termination unless the truster agrees or the court grants approval. Approval will be withheld if the variation or termination is inconsistent with a material purpose of the trust. The paper rejects introducing this scheme into Scots law and proposes putting the existing Scottish position on a statutory basis.

## **Variation or termination by the courts**

4. Where a variation or termination cannot be done by agreement because some or all of the beneficiaries are under 18, incapable, unborn or not yet ascertained, the court may grant approval on their behalf under section 1 of the Trusts (Scotland) Act 1961. The court must be satisfied that these beneficiaries will not be prejudiced. All the other capable adult beneficiaries must also agree.

5. A guardian of an incapable adult may agree on the adult's behalf which avoids having to go to court for approval. Views are sought on whether:

- Parents should be able to agree to a variation or termination on behalf of their children under 16.
- Children aged 16 or 17 should be able to agree themselves.

These changes would reduce the number of cases where the court has to be involved.

6. There may be beneficiaries whose chances of benefiting are extremely remote as they depend on one or more unlikely events occurring. It is often very difficult to identify and notify all the remote beneficiaries of the proposed variation. However, if the unlikely events do occur the benefit due from the trust may be large. The remote beneficiaries might be regarded as holding a National Lottery ticket and it would be a breach of the European Convention on Human Rights to deprive them of the chance of benefiting. The paper suggests that the court should be able to grant approval of a variation if satisfied that their interest was of negligible value, but the court's approval would simply protect the trustees. If the contingency occurred the beneficiaries could claim from those who had benefited from the varied or terminated trust. The paper also suggests that the court could be given power to approve an arrangement despite a risk of prejudice to an unborn beneficiary, provided the court is satisfied that there is no reasonable prospect of the interest ever coming into existence.

7. Other changes are suggested in order to improve the usefulness of the court approval procedure. These include:

- Prejudice to a beneficiary not being assessed in purely financial terms.
- The court being able to over-rule a refusal to consent by adult capable beneficiaries if satisfied that they would not be prejudiced by the variation or termination.
- The court being able to approve on behalf of untraceable beneficiaries if satisfied that they would not be prejudiced by the variation or termination.

### **Non-charitable public trusts**

8. There are a variety of ways in which public trusts can be re-organised, depending on whether they are charitable, non-charitable, or educational endowments, whether they are large or small, and whether they fail after they have been established or there is some initial flaw. Simplification while retaining public accountability is desirable. Proposals include:

- Creating a new scheme for extra-judicial re-organisation of non-charitable public trusts and educational endowments paralleling that of charitable trusts under the Charities and Trustee Investment (Scotland) Act 2005.
- Replacing the court's common law cy-près jurisdiction by a statutory scheme applicable to both charitable and non-charitable public trusts.

# Part 1 Introduction

## The Trust Law Review

1.1 This discussion paper deals with the variation and termination of private trusts and the reorganisation of non-charitable public trusts. It is the first to be published in Phase 2 of our review of trust law. In Phase 1, which concentrated on trustees and their powers and duties, we published discussion papers on breach of trust, on the allocation and apportionment of receipts and outgoings between various classes of beneficiary, and on trustees and trust administration.<sup>1</sup> We intend to publish a discussion paper on the nature and constitution of trusts early next year. Phase 2 will also cover 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.

## Advisory Group

1.2 We continue to be assisted by an Advisory Group comprising both practitioners and academics, whose members are listed in Appendix C. Members of the Group have commented on a preliminary policy paper and a draft of this discussion paper. We are very grateful to them for their helpful and practical comments on these earlier papers.

## Outline of this Discussion Paper

1.3 Most of this discussion paper is concerned with the variation and termination of private trusts. We deal firstly with variation or termination by agreement among beneficiaries and secondly with judicial approval of arrangements varying or terminating trusts.

1.4 Part 2 outlines the present law in relation to both extra-judicial variation and judicial approval of variation of trusts. As regards extra-judicial variation, where all possible beneficiaries of the trust are of full age and capacity and there are no continuing trust purposes which require retention of trust property by the trustees, the beneficiaries may agree among themselves to bring the trust to an end or to vary its terms, even if this does not accord with the wishes of the truster. Variation or termination cannot, however, proceed by agreement among the beneficiaries where one or more of them lack the capacity to agree (for example because they are children), or where there are unborn or unascertained beneficiaries. In such circumstances, an application may be made to the Court of Session under section 1 of the Trusts (Scotland) Act 1961 for approval on behalf of the minor, unborn or unascertained beneficiary of an arrangement terminating the trust or amending its terms. The court may approve the arrangement if satisfied that it is not prejudicial to any of the persons upon whose behalf its approval is sought. The court may also authorise a scheme which varies or terminates an alimentary liferent, provided that certain conditions are satisfied.

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<sup>1</sup> 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.

1.5 In relation to variation both by extra-judicial agreement and by judicial approval, Scots law follows English law in placing greater emphasis on the wishes of the beneficiaries than those of the trustee. By way of contrast, United States law requires an application to the court in any case in which the trustee is not a party to the agreement varying the trust provisions. The court may approve the modification or termination of the trust only if satisfied that what is proposed is not inconsistent with a material purpose of the trust. This approach, which places greater emphasis on the wishes of the trustee than those of the beneficiaries, is examined in Part 3.

1.6 In Part 4 we discuss proposals for reform of the law in relation to variation or termination of trusts by agreement. We express the provisional view that there is no need to adopt an approach which gives greater weight to the wishes of the trustee.<sup>2</sup> We consider whether a parent as legal representative should have power to consent on behalf of a child to the variation or termination of a trust and, if so, in what circumstances, bearing in mind that there could be a conflict of interest between parent and child.<sup>3</sup> We propose that no change in the law is necessary in relation to the giving of consent on behalf of an adult beneficiary with incapacity.<sup>4</sup> Finally, we propose one minor change in the law in relation to extra-judicial variation of a trust in which an alimentary liferent subsists.<sup>5</sup>

1.7 In Part 5 we make proposals for reform of the statutory provisions regarding judicial approval of schemes to vary or terminate trust provisions. Consistently with our proposals regarding extra-judicial agreement, we do not propose the introduction of a "material purpose" test for court approval.<sup>6</sup> We suggest that the existing statutory provisions might be amended in order to permit the court to approve a scheme despite the possibility of the occurrence of certain highly improbable events, such as the birth of a child to an elderly man or woman.<sup>7</sup> We invite comment on the factors to which the court should have regard in assessing whether or not a proposed scheme is prejudicial to a person on whose behalf approval is sought.<sup>8</sup> We propose that, even if parents are to have power to approve schemes on behalf of children, it should remain competent to apply to the court for approval on behalf of children.<sup>9</sup> We consider ways in which the granting of court approval may be facilitated where there are untraceable beneficiaries<sup>10</sup> and where there is an adult beneficiary who refuses consent despite not being prejudiced by the proposal.<sup>11</sup> Finally, we consider various miscellaneous proposals for reform.<sup>12</sup>

1.8 In Part 6 we turn to consider the reorganisation of non-charitable public trusts. The Charities and Trustee Investment (Scotland) Act 2005 introduces a comprehensive new regime for the regulation of charities, including charitable trusts, in Scotland. This regime includes a mechanism whereby the new Office of the Scottish Charity Regulator ("OSCR") may approve a reorganisation scheme amending the constitution of a charity where, for example, the existing provisions have ceased to provide a suitable and effective method of

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<sup>2</sup> See paras 4.1 – 4.9 below.

<sup>3</sup> See paras 4.10 – 4.21 below.

<sup>4</sup> See paras 4.22 – 4.23 below.

<sup>5</sup> See paras 4.24 – 4.25 below.

<sup>6</sup> See paras 5.1 – 5.5 below.

<sup>7</sup> See paras 5.8 – 5.25 below.

<sup>8</sup> See paras 5.26 – 5.30 below.

<sup>9</sup> See paras 5.31 – 5.32 below.

<sup>10</sup> See paras 5.33 – 5.34 below.

<sup>11</sup> See paras 5.35 – 5.37 below.

<sup>12</sup> See paras 5.38 – 5.43 below.

using the trust property. The Charities Act does not, however, apply to non-charitable public trusts which remain governed by the provisions of sections 9 -11 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 and which, except in the case of small trusts, require a court application for approval of a reorganisation scheme. We consider various alternative solutions and propose that the rules for reorganisation of non-charitable public trusts be brought into line with those of charitable trusts.<sup>13</sup> We also discuss whether the statutory regime for both charitable and non-charitable public trusts should be extended to include matters presently dealt with by way of an application to the *nobile officium* of the Court of Session for approval of a *cy-près* scheme, notably where there is initial failure of the trust purposes.<sup>14</sup> Finally, we invite comment as to who would be responsible for giving extra-judicial approval of reorganisation schemes for such trusts.<sup>15</sup>

### **Legislative competence**

1.9 The proposals in this discussion paper relate to the variation and termination of private trusts, and the reorganisation of non-charitable public trusts, none of which are reserved matters under the Scotland Act 1998. They therefore lie within the legislative competence of the Scottish Parliament.

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

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<sup>13</sup> See paras 6.12 – 6.16 below.

<sup>14</sup> See paras 6.17 – 6.22 below.

<sup>15</sup> See paras 6.23 – 6.25 below.

## Part 2            The present law

### Extra-judicial termination of trusts

2.1     In certain circumstances a trust may be brought to an end by the beneficiaries prior to the date, or occurrence of the event, specified by the truster. This is generally known as the rule in *Miller's Trustees*. In the case of *Miller's Trustees v Miller*,<sup>1</sup> a testator directed his trustees to hold property for his second son until the latter attained age 25. The property was to vest on his attaining age 25 or on marrying with the consent of the trustees after attaining age 21. The son married, with the trustees' consent, after attaining age 21 but before reaching 25, and called on the trustees to make over the capital to him. In view of the existence of a number of previous conflicting decisions, a court of seven judges heard the case and held, by a 5-2 majority, that the son was entitled to have the capital made over to him despite the testator's direction that it should not be paid until he attained age 25. Lord President Inglis stated:<sup>2</sup>

"There is, in my opinion, a general rule, the result of a comparison of a long series of decisions of this Court, that where by the operation of a testamentary instrument the fee of an estate or parts of an estate, whether heritable or moveable, has vested in a beneficiary, the Court will always, if possible, relieve him of any trust management that is cumbrous, unnecessary, or expensive. Where there are trust purposes to be served which cannot be secured without the retention of the vested estate or interest of the beneficiary in the hands of the trustees, the rule cannot be applied, and the right of the beneficiary must be subordinated to the will of the testator. But I am not aware of any case in which the mere maintenance of a trust arrangement without any ulterior object or purpose has been held to be a trust purpose in the sense in which I have used that term."

Lord McLaren's rationale was somewhat different:<sup>3</sup>

"It seems to me that a beneficiary who has an estate in fee has by the very terms of the gift the same right of divesting the trustees, and so putting an end to the trust, which the truster himself possessed, because under a gift in fee the grantee acquires all the rights in the property which the truster had to give. It seems to me to be not only an unsound proposition in law, but a logical impossibility, that a person should have an estate in fee, and that some other person should at the same time have the power of withholding it. This I understand to be a well-settled principle. It is laid down by writers of authority on the law of England, and I have never had any doubts about its being the law of Scotland..."

There are only two exceptions, so far as I know, to the operation of this general rule, as I understand it, and these are founded on civil disability – I mean the case of marriage and the case of minority or mental incapacity. The case of minority or mental incapacity is only an apparent exception, because the trustees are only possessors in the character of the guardians of the estate of a beneficiary who is not in the position to manage the property for himself..."

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<sup>1</sup> (1890) 18 R 301.

<sup>2</sup> *Ibid* at 305, Lord Justice-Clerk Macdonald, Lord Rutherford Clark and Lord Adam concurring.

<sup>3</sup> *Ibid* at 310.

2.2 In his dissenting opinion, Lord Young<sup>4</sup> took the view that the truster's direction ought to receive effect, observing:<sup>5</sup>

"I must say that I am startled by the suggestion that that is illegal – that no father is entitled to have such an idea in his mind, and that the law will frustrate whatever he does in order to accomplish it. The vesting of the right and the coming into possession are totally different things. There is nothing more common, as I have pointed out already, than for complete vesting to take place in the merest infant. But the withholding of possession is another matter altogether. A father or any other person may have any of a variety of reasons for desiring that an estate shall not be put into the management of his son, whom he desires to be the proprietor of it, until he is twenty-five."

2.3 After *Miller's Trustees*, Lord Young continued to dissent in cases which raised similar issues and, in view of such continuing differences of opinion, and some doubt as to the *ratio* of *Miller's Trustees*, the matter was brought before the whole court for reconsideration in *Yuill's Trustees v Thomson*.<sup>6</sup> In this case a testator directed the trustees to retain the shares of certain capital beneficiaries after they had attained a vested interest, and to pay them neither capital nor income so long as their fathers should be alive. The majority held that the beneficiaries were entitled to receive their shares of capital. The rule in *Miller's Trustees* was stated as follows:<sup>7</sup>

"The principle of that decision is that when a vested, unqualified and indefeasible right of fee is given to a beneficiary of full age, he is entitled to payment of the provision notwithstanding any direction to the trustees to retain the capital of the provision, and to pay over the income periodically, or to apply the capital or income in some way for his benefit. The proposition is qualified in the opinion of Lord President Inglis by the addition that, where there are trust purposes to be served which cannot be secured without the retention of the vested estate or interest of the beneficiary in the hands of the trustees, the rule cannot be applied, and the right of the beneficiary must be subordinated to the will of the testator."

This formulation contains elements of both of the majority opinions in *Miller's Trustees* set out above, and has since been accepted as an authoritative expression of the rule.

2.4 The practical consequence of the rule is that the will of the truster is subordinated to that of a beneficiary of full age and capacity. The truster's intention that the property should remain subject to the trust provisions after an adult has obtained a vested interest is overridden provided that there are no other continuing trust purposes, such as a liferent or annuity, to be implemented. An example of the operation of the rule is afforded by the case of *Smith's Trustees v Michael*,<sup>8</sup> in which it was held that, despite the contrary intention of the truster (who was alive and represented in court), a discretion of the trustee as to time of payment could not be attached to a vested and indefeasible interest. The equivalent rule in English law is known as the rule in *Saunders v Vautier*.<sup>9</sup> Although it is perhaps easier to state a theoretical justification for the rule in the context of English law, under which a trust

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<sup>4</sup> Lord Trayner concurring.

<sup>5</sup> *Ibid* at 308.

<sup>6</sup> (1902) 4 F 815

<sup>7</sup> *Ibid* at 819 in the opinion of Lord President Balfour, Lord Adam, Lord McLaren and Lord Kinnear; Lords Kyllachy, Stormonth, Darling and Low and Lord Justice-Clerk Macdonald concurring.

<sup>8</sup> 1972 SLT 89.

<sup>9</sup> (1841) Cr & Ph 240. This case was among the authorities cited to the court in both *Miller's Trs* and *Yuill's Trs v Thomson*, though it is not referred to in any of the opinions delivered.

beneficiary is regarded as having beneficial (though not legal) ownership of the trust property, it seems clear from the dicta cited above that the rule is seen in Scotland as a matter of policy.

2.5 The particular decisions of the court in *Miller's Trustees* and in *Yuill's Trustees v Thomson* concern only the entitlement of an individual beneficiary whose interest is vested and indefeasible. The rule has, however, been regarded as wider, entitling beneficiaries whose interests (whether vested or not) when taken together amount to the whole interest in the trust fund to join together and require that the trust be terminated and the capital distributed. There is little direct Scottish authority for this interpretation of the rule. In *Gray v Gray's Trustees*,<sup>10</sup> which preceded *Miller's Trustees* itself, Lord Gifford observed:<sup>11</sup>

"When, in a private trust, every possible beneficiary desires and consents to a particular course being adopted – all the beneficiaries being of full age and *sui juris* – and none of them being placed under any restraint or disability by the trust-deed itself – then no-one has any right or interest to object, and the Court will not interfere to prevent the sole and unlimited proprietors doing what they like with their own."

2.6 In response to this observation it might be pointed out, firstly, that the beneficiaries are *not* the proprietors of the trust fund and, secondly, that although the truster may have no financial interest in his own trust, he might nevertheless feel that he should have a right to prevent his express wishes being flouted. However, Scots law has not hitherto recognised such a right. In *Earl of Lindsay v Shaw*,<sup>12</sup> under reference to *Gray v Gray's Trustees*, Lord Justice-Clerk Thomson robustly observed:

"Trusts are created by trusters for the benefit of certain nominated beneficiaries and trustees are appointed merely to see that the interests of the beneficiaries are protected. If the beneficiaries being of full age and sound sense discharge their benefits, the trustees have no interest to prevent them doing so or to attempt to protect them from themselves. In such circumstances trustees are administrators, not nursemaids. This is so elementary as hardly to need authority ..."

Another possible objection to allowing beneficiaries who are of full age and capacity to agree to terminate the trust is that they might all fail to survive until the vesting date, in which case the trust fund would be held under a resulting trust for the truster. Depending on circumstances, this risk may be more or less realistic. Neither the Scottish nor the English authorities appear to regard it as an obstacle to termination by agreement among the beneficiaries.

2.7 It is important to emphasise that the wide interpretation of the rule in *Miller's Trustees* applies even where the interests of the beneficiaries have not yet vested. On the other hand, a common feature of the cases mentioned above is that all of the beneficiaries were of full age and capacity. This is a pre-requisite for the application of the rule: the existence of a minor or incapable adult beneficiary precludes termination of the trust by agreement among the beneficiaries. It follows, logically, that the rule does not envisage the distribution of any part of the trust capital to a minor or *incapax* beneficiary. So, for example, it is not open to the major beneficiaries alone to agree to terminate the trust, even where the terms of the agreement would plainly be for the financial benefit of a child.

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<sup>10</sup> (1877) 4 R 378.

<sup>11</sup> *Ibid* at 383. See also Lord Justice-Clerk Inglis at 382.

<sup>12</sup> 1959 SLT (Notes) 13.

## Extra-judicial variation of trusts

2.8 There is no clear authority for the proposition that beneficiaries who would together have the capacity to terminate a trust also have the capacity to vary its terms, so that the property remains in trust but is subject to altered trust provisions. The rule in *Miller's Trustees* is concerned specifically with the right of a beneficiary of full age to demand that property to which he has a vested, indefeasible right be made over to him. In *Gray's Trustees*,<sup>13</sup> the trustees considered it necessary to seek the court's approval of a scheme altering the terms of the trust. It seems, however, that if a beneficiary has a right to direct that trust assets be made over to him absolutely, it must follow that this right extends to directing that these assets be made over to a third party (such as new trustees), or that they be held by the trustees for new or amended purposes. Similarly, if the beneficiaries together are entitled to demand that the trust be brought to an end, it follows that they may together decide that the purposes shall be varied. This is clearly established in England.<sup>14</sup> Again, the only situation envisaged is where all the beneficiaries (whether or not with vested interests) are of full age and capable of consenting, and where they do in fact all agree to vary the terms of the trust. The existence of a minor or incapable adult beneficiary would preclude variation by agreement in the same way as it precludes premature termination by agreement.

2.9 Although there is no direct authority, the same principle would appear to apply to a variation by consent which affects only part of the trust fund. Provided that all the possible beneficiaries in that part of the fund are of full age and consent to a variation of the terms, as a matter of principle, it should not be necessary to obtain the consent of a beneficiary with an interest which is unaffected by the proposed change. It is important, however, to distinguish between, on the one hand, an interest which is unaffected by the variation and, on the other hand, an interest which is not *adversely* affected by it. In the latter situation, consent of the beneficiary in question is needed, even if the absence of prejudice to him is obvious.

## Judicial approval of variation and termination of trusts

2.10 Prior to 1961, the circumstances in which a court could interfere with the dispositive provisions of a trust deed were equally restricted. The only relevant power available to the court was that conferred by the Trusts (Scotland) Act 1921, section 16 to authorise trustees to make advances from the capital of a fund destined either absolutely or contingently on survivorship to beneficiaries not of full age, if such advance was necessary for their maintenance or education and was not expressly prohibited by the trust deed. By virtue of section 1 of the Trusts (Scotland) Act 1961 (referred to in this Discussion Paper as "the 1961 Act"), however, the court was given power to approve an arrangement varying or revoking trust purposes on behalf of incapable, unborn or unascertained beneficiaries, provided it is satisfied that the carrying out of the arrangement is not prejudicial to any person on whose behalf approval is sought.

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<sup>13</sup> See para 2.5 above.

<sup>14</sup> The rule in *Saunders v Vautier* has been stated as follows: "If the beneficiaries are adults under no disability and entitled between them to the whole beneficial interest they can terminate the trust and divide the trust property between them": Underhill & Hayton, *Law of Trusts and Trustees* (16<sup>th</sup> edn, 2003), p 27. In *IRC v Holmden* [1968] AC 685, Lord Wilberforce observed at 713: "If all the beneficiaries under the settlement had been *sui juris*, they could, in my opinion, have joined together with the trustees and declared different trusts which would supersede those originally contained in the settlement".

2.11 The reform effected by section 1 of the 1961 Act followed upon a similar reform in England and Wales, and it is therefore helpful to summarise the circumstances in which the latter reform occurred. In the years following the Second World War, the incidence of taxation rendered it desirable to amend the terms of trusts which had been created many years previously during an earlier and less onerous tax regime. Such amendment was not possible by agreement among beneficiaries where, as would usually be the case, the beneficiaries with an interest in the trust included minor, unborn or unascertained persons. A practice grew up in the Chancery Division whereby litigation would be commenced with a view to seeking the court's sanction of a scheme compromising the "dispute". For some years the court was willing to accept jurisdiction to sanction such schemes. Most orders were made in chambers and few such cases were reported. This practice was brought to a halt by the decision of the House of Lords in *Chapman v Chapman*,<sup>15</sup> in which it was held by a majority that the court did not have an unlimited jurisdiction to sanction trust variation schemes on behalf of minor and other potential beneficiaries where the respective rights of the parties were not in dispute. It remained possible to seek court approval of a scheme in circumstances where the terms of a settlement were ambiguous so as to give rise to a genuine dispute, or where the trust fund consisted of land or the proceeds of a sale of land.

2.12 In 1957 the Law Reform Committee produced a report<sup>16</sup> recommending that the court should be given statutory power to do what it had been doing prior to the decision in *Chapman v Chapman*. The result was the enactment of the Variation of Trusts Act 1958, conferring a statutory jurisdiction on the court to approve an arrangement varying or revoking trust provisions on behalf of certain categories of beneficiary (including minor and unborn beneficiaries), provided that the court was satisfied that the arrangement was for the benefit of the persons on whose behalf approval was sought.<sup>17</sup>

2.13 The Variation of Trusts Act 1958 did not extend to Scotland. However, the same practical problems had been encountered here with regard to the incidence of income tax and estate duty on trusts which had been designed some years previously to endure unchanged for successive generations. The matter was considered in 1960 by the Law Reform Committee for Scotland.<sup>18</sup> The Committee noted<sup>19</sup> that in Scotland, as in England, it had been possible to "break" trusts by agreement only where all the beneficiaries were of full legal capacity. It was also noticed<sup>20</sup> that although the variation of trusts by sanction of the court was no new thing in England, it would represent a fundamental innovation in Scotland. Nevertheless, the Committee were satisfied that this innovation should be adopted in Scotland.

2.14 The recommendation made by the Law Reform Committee for Scotland followed closely the phraseology of the English legislation. So far as the truster was concerned, the Committee's view<sup>21</sup> was that, if alive, his consent should not be essential, ie that he should not have a right of veto, but that he should have a right to appear and state objections. The

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<sup>15</sup> [1954] AC 429.

<sup>16</sup> Law Reform Committee, Sixth Report, *Court's Power to Sanction Variation of Trusts*, Cmnd 310 (1957).

<sup>17</sup> Many Commonwealth jurisdictions, whose common law was similar to that of England and Wales and included the rule in *Saunders v Vautier*, have enacted legislation similar to the 1958 Act.

<sup>18</sup> Law Reform Committee for Scotland, Ninth Report, *The Powers of Trustees to Sell, Purchase or Otherwise Deal with Heritable Property; and the Variation of Trust Purposes*, Cmnd 1102 (1960).

<sup>19</sup> *Ibid*, para 32.

<sup>20</sup> *Ibid*, para 39.

<sup>21</sup> *Ibid*, para 57.

principal recommendations of the Committee were given effect by section 1 of the Trusts (Scotland) Act 1961.<sup>22</sup> At that time the age of majority was 21. It was reduced to 18 by the Age of Majority (Scotland) Act 1969, whereupon persons aged between 18 and 20 became capable of consenting to arrangements varying or terminating trust provisions. When the age of full legal capacity was further reduced to 16 by the Age of Legal Capacity (Scotland) Act 1991, special provision was made for consent to variation and termination of trusts. A person aged 16 or 17 is deemed to be incapable of assenting to such variation or termination, so that court approval on his or her behalf is still required, but the court must take such account as it thinks appropriate of the beneficiary's attitude to the arrangement.<sup>23</sup>

2.15 As had been the case in England, the reform effected by the 1961 Act was driven largely by tax-related considerations. The Law Reform Committee for Scotland observed:<sup>24</sup>

"...The provisions of the old fashioned settlement were designed to preserve the settled property for successive generations. Under modern conditions, particularly looking to the impact of taxation, such provisions, so far from preserving settled property, may have the opposite effect. ...If the income be substantial and payable to a single liferenter, it may be largely absorbed by tax; if capital cannot be paid over to beneficiaries, but must be retained until the death of a liferenter, it may be largely swallowed up by estate duty, with the principle of aggregation swelling the exaction in many cases."

In the early days of the operation of the Act, many applications had the object of bringing trusts to an end by partitioning the fund on an actuarial basis between the liferenter on the one hand and the persons prospectively or contingently interested in the fee on the other. Mitigation of tax has continued ever since to be the primary reason for applications under the Act, although the particular reasons for wishing to vary trusts have changed as tax law has developed. Following the extension of estate duty to discretionary trusts in 1969, there were a large number of schemes whose purpose was to convert discretionary trusts into other forms of settlement, such as accumulation and maintenance trusts. This trend continued during the early years of capital transfer tax in the late 1970s when, for a transitional period, reduced rates of tax applied to capital distributions out of discretionary trusts. By the 1980s most of the "old fashioned settlements" described by the Committee had been brought to an end or had been converted into more tax-efficient vehicles. However, with the introduction and subsequent restriction of capital gains tax hold-over relief in relation to property leaving trusts, a further category of arrangements has developed in which charges to capital gains tax are avoided or at least postponed by prolonging income interests, so that beneficiaries' interests in capital do not vest until they attain an age such as 50 or 60 instead of the age of, say, 25 or 30 specified in the trust deed. It is understood that a significant proportion of the applications currently made under section 1 of the 1961 Act are along these lines.

### **Alimentary liferents**

2.16 An interest in the income of a trust, such as a liferent or annuity, may be declared by the truster to be "alimentary", in which case particular restrictions attach to it.<sup>25</sup> The alimentary liferent is a peculiarly Scottish institution, fulfilling a role broadly similar to that of

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<sup>22</sup> Section 1 (as subsequently amended) is reproduced in Appendix A.

<sup>23</sup> *Ibid*, s 1(2), as substituted by the Age of Legal Capacity (Scotland) Act 1991, Sch 1.

<sup>24</sup> *Op cit*, para 41.

<sup>25</sup> No specific form of wording is required in order to create an alimentary right, but the most common means of achieving the restriction is to declare the interest to be alimentary.

the protective trust under English law and the spendthrift trust in the United States. Its principal features are as follows:

- It may not be renounced or assigned by the beneficiary after he or she has entered into enjoyment of it;<sup>26</sup>
- It cannot be arrested by creditors except to the extent that instalments of income have actually fallen due to the beneficiary.

It is not competent for a person to create an interest in his own favour with an alimentary restriction, with a view to protecting his future income from creditors.<sup>27</sup> Moreover, the protection afforded by the alimentary restriction is effective only in so far as it is of reasonable amount, having regard to the circumstances of the beneficiary. The liferent provision is arrestable (and, probably, assignable) in so far as it is in excess of a sufficient alimentary income. It has been held that the alimentary beneficiary may not competently grant an assignation of such future sums as he estimates will exceed his alimentary needs, as this would be to favour current general creditors over future alimentary creditors.<sup>28</sup>

2.17 Use of alimentary liferents in Scots law has in the past been closely bound up with ante-nuptial marriage contracts. They were regularly used as a means of protecting the wife's property from dissipation by her husband during the subsistence of his *jus mariti* and *jus administrationis*, ensuring that recourse could not be had to her assets to satisfy the husband's business or personal debts. In 1961, Lord President Clyde observed:<sup>29</sup>

"The doctrine of an alimentary annuity is a survival from an age when the *ius mariti* and the *ius administrationis* gave a husband virtual control over his wife's property. Without some such provision the weaker partner in the marriage could be compelled to hand over to her husband to pay his personal debts moneys which were intended for her benefit and use. The provision of an alimentary annuity under a trust, however, enabled funds to be put beyond the reach of matrimonial importunity – see Lord Justice-Clerk Moncreiff in *Menzies v Murray* [(1875) 2 R 507] at 511. For the existence of the trust and the alimentary nature of the annuity placed a restriction on the wife disabling her from anticipating the termly payments and getting them into her hands before they were due. For once in her hands, they were subject to her husband's control."

With the abolition in 1984 of the right of a woman to create an alimentary provision in her own favour in an ante-nuptial marriage contract, such use of alimentary liferents is largely

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<sup>26</sup> See eg *Douglas Hamilton v Duke and Duchess of Hamilton's Trs* 1961 SC 205, Lord President Clyde at 219.

<sup>27</sup> Prior to 1984 it was competent for a woman (though not a man) to create an alimentary provision in her own favour in an ante-nuptial marriage contract. This power (which echoed the English "restraint on anticipation") was abolished by the Law Reform (Husband and Wife) (Scotland) Act 1984, s 5(1)(a).

<sup>28</sup> *Cuthbert v Cuthbert's Trs* 1908 SC 967. Alimentary debts have been defined as "all articles of annual expenditure required for the comfort, or suitable to the situation of the party"; *Greig v Christie* (1837) 16S 242, Lord Fullerton at 244. A creditor who has made an advance for alimentary purposes is an alimentary creditor; *Waddell v Waddell* (1836) 15S 151. See further Wilson, *The Scottish Law of Debt* (2<sup>nd</sup> edn, 1991), pp 193-4.

<sup>29</sup> *Douglas Hamilton v Duke and Duchess of Hamilton's Trs* 1961 SC 205 at 217. cf the Ninth Report of the Law Reform Committee for Scotland on inter alia the variation of trust purposes (1960 Cmnd 1102) at para 51: "We have received no representations urging the total abolition of alimentary liferents, and we would not favour this course, as they still have certain advantages – for example as a protection for a liferenter against the importunity of a fiar."

obsolete, although it remains competent for parties to a marriage contract to create interests with alimentary restrictions in favour of one another.<sup>30</sup>

2.18 The alimentary liferent has also been used, however, and continues to be used, outside the context of marriage contract trusts as a means of protecting a beneficiary from his or her own financial weaknesses. Lord President Inglis put the matter thus:<sup>31</sup>

"...If a settler desires to provide an alimentary payment to some person in whom he has a want of confidence (as is to be inferred in the present case from the clause referred to), and desires to make a provision which the party recipient shall not have the power to discharge or assign, or give up in any way, he may do this: he may place a sum of money in the hands of trustees, and may direct them to use that money in such a way that without a breach of trust they could not possibly listen either to an assignee or an arresting creditor, because the directions of the truster would be – as they are in this trust deed – 'You shall pay over term by term a certain sum of money to the beneficiary whom I have named. You shall not pay it to anybody else. The trust is created for the purpose of the money going into her hands, and I forbid and restrain you from doing anything else with it.' "

In modern practice it is possible to utilise an alimentary liferent in making provision, in either an *inter vivos* or a *mortis causa* trust, for a beneficiary who, though of full age, is not regarded by the truster as wholly reliable in his or her use of an income entitlement. It is also used to protect funds from claims by a beneficiary's spouse in the event of divorce.

2.19 The fact that an alimentary liferent cannot be discharged by the beneficiary means that it is not competent for a trust containing such a provision to be terminated by the extra-judicial consent of all the beneficiaries, or to be varied by consent in any way which affects the interest of the alimentary liferenter. This constituted a second and separate obstacle to judicial approval of variation of trusts at the time when legislation for Scotland along the lines of the English 1958 Act was being considered. The Law Reform Committee accordingly recommended<sup>32</sup> that if the alimentary liferenter, being of full capacity, was prepared to consent to an arrangement varying the terms of the trust, the court should have power to approve the arrangement on his behalf, provided that the court considered it reasonable to do so, having regard particularly to the amount of the liferenter's income from all sources at the date of the application, and such other factors, if any, as the court might consider material. A provision to this effect was included as section 1(4) of the Trusts (Scotland) Act 1961.<sup>33</sup>

### Further reform

2.20 The 1961 Act effected a very useful and successful reform. In a series of applications made shortly after the Act took effect,<sup>34</sup> the court took the opportunity to give guidance as to how the requirements of section 1 might be met, and to lay down procedural

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<sup>30</sup> It may also be noted that under the Family Law (Scotland) Act 1985, s 14(2)(h), the court's powers in relation to financial provision on divorce include power to make an incidental order setting aside or varying any term in an antenuptial or postnuptial marriage settlement.

<sup>31</sup> *White's Trs v Whyte* (1877) 4 R 786 at 790.

<sup>32</sup> Law Reform Committee for Scotland, Ninth Report, *The Powers of Trustees to Sell, Purchase or Otherwise Deal with Heritable Property; and the Variation of Trust Purposes*, Cmnd 1102, (1960), para 49-52.

<sup>33</sup> The court's power in relation to alimentary liferents is referred to in the Act as "authorisation" as opposed to "approval".

<sup>34</sup> Eg *Colville Petitioner* 1962 SC 185; *Robertson & Others, Petitioners* 1962 SC 196; *Findlays, Petitioners* 1962 SC 210; *Tulloch's Trs, Petitioners* 1962 SC 245; *Young's Trs, Petitioners* 1962 SC 293.

guidelines which continue to be followed today. Since the initial period when the ground rules were being established, there have been few reported cases on the operation of section 1, and almost no adversarial proceedings. Hearings normally take the form of *ex parte* applications in which the court proceeds on the basis of the documents lodged and the statements of fact made in the petition and by counsel at the bar. The procedure is reasonably expeditious and hearings normally last less than an hour. It is understood that there are approximately five or six such applications each year.

2.21 We consider, however, that, more than 40 years after the passing of the 1961 Act, further reform may now be desirable. Intervening legislation such as the Age of Legal Capacity (Scotland) Act 1991, the Children (Scotland) Act 1995 and the Adults with Incapacity (Scotland) Act 2000 has altered the statutory background regarding capacity to consent to transactions such as trust variations. Applications to the court for approval of arrangements continue to be driven predominantly by tax-saving considerations. The type of application likely to come before the court has however changed: in current practice it is more common to use the procedure to extend the life of a trust (for example, in order to avoid or postpone an imminent charge to capital gains tax) than to bring it to an end. In certain respects the present procedure has shown itself to be inflexible, especially when addressing remote theoretical contingencies. Another concern is that in addressing the question of absence of "prejudice" the Court of Session has looked solely to financial prejudice, whereas in England the corresponding requirement, namely that the arrangement should be for the "benefit" of the person on whose behalf approval is sought, has been more broadly interpreted. The consequence of these shortcomings is that applications under section 1 are sometimes reduced to an intellectual exercise in which possible courses of action have to be discarded because of risks which may be wholly theoretical. A common example is where the potential "prejudice" would arise in the event of the birth of further issue to a 75-year old man. Changes in social attitudes suggest that the law in relation to variation or termination of alimentary liferents may also be worthy of re-examination.

2.22 In considering reforms to the present law we have had in mind the following objectives:

- (i) To widen the circumstances in which a trust may be varied or terminated without the need to involve the court at all; and
- (ii) To remove some of the obstacles which under the present law preclude the court from approving an arrangement.

We do not intend that our proposals should extend to special types of trust such as pension scheme trusts and unit trusts. Nor are they, by their nature, likely to be of any relevance to trusts created in a commercial context.

## Part 3      The United States "material purpose" rule

### Historical background

3.1 Unlike Scots law, the United States has not followed English law down the route indicated by *Saunders v Vautier* which permits variation or termination of trusts by agreement among beneficiaries, even when the consequences are in conflict with the stated wishes of the truster<sup>1</sup>. At first American courts adopted the same approach. However, in 1889 the Supreme Judicial Court of Massachusetts changed the subsequent course of US law by its decision in *Claffin v Claffin*.<sup>2</sup> The truster directed his trustees to pay part of the residue of his estate to his son in instalments: \$10,000 at age 21, \$10,000 at age 25, and the balance at age 30. Having reached the age of 21 and having attained a vested interest in the fund, the son sought payment of the whole fund. The court upheld the truster's scheme for payment, observing:

"...A testator has the right to dispose of his own property with such restrictions and limitations, not repugnant to law, as he sees fit, and ...his intentions ought to be carried out, unless they contravene some positive rule of law, or are against public policy..."

3.2 Courts in other states followed suit. The test established by *Claffin v Claffin* came to be known as the "material purpose" rule, and may be stated as follows: a trust cannot be terminated prior to the time fixed for termination, even though all the beneficiaries consent, if termination would be contrary to a material purpose of the truster. The scope of the phrase "material purpose" is unclear and has been the subject of dispute.<sup>3</sup> Evidence for determining whether there is a material purpose is not restricted to the terms of the deed but may also be drawn from surrounding circumstances.

"Material purposes are not readily to be inferred. A finding of such a purpose generally requires some showing of a particular concern or objective on the part of the settlor, such as concern with regard to the beneficiary's management skills, judgment, or level of maturity. Thus, a court may look for some circumstantial or other evidence indicating that the trust arrangement represented to the settlor more than a method of allocating the benefits of property among multiple beneficiaries, or a means of offering to the beneficiaries (but not imposing on them) a particular

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<sup>1</sup> In the United States, as in England and Wales, the term used for the person settling property on trust is "settlor". For the sake of consistency the term "truster" is used throughout this paper, regardless of the jurisdiction being discussed.

<sup>2</sup> 20 NE 454 (Mass 1889). For a more detailed account of the US historical background, see Ronald Chester, "Modification and termination of trusts in the 21<sup>st</sup> century: The Uniform Trust Code leads a quiet revolution", (2001) 35 Real Property, Probate and Trust Journal, Winter 2001.

<sup>3</sup> Eg where a life interest is granted to A with power to appoint the capital by will, some courts have held that this discloses a material purpose that the life interest should not be terminated before A's death; other courts have taken the opposite view.

advantage. Sometimes, of course, the very nature or design of a trust suggests its protective nature or some other material purpose."<sup>4</sup>

In Missouri the "material purpose" rule has been abolished by statute.

3.3 The material purpose rule is of particular significance in relation to so-called "spendthrift trusts": ie trusts containing provisions intended to protect beneficiaries against their own lack of financial responsibility. Spendthrift trusts resemble alimentary liferents under Scots law in that the beneficiary's interest is non-assignable, but differ in that (i) the trustee has a discretion as to how much, if any, of the income produced by the trust fund to pay over to the beneficiary, and (ii) an interest in fee can (in most states) be subject to a spendthrift restriction. In some states creditors are given statutory rights against the beneficiary's interest to the extent that the income exceeds the beneficiary's needs for education and maintenance of his station in life. The provision may also be overridden by claims for aliment by the beneficiary's spouse or children, or by claims by the government. A spendthrift provision has generally been regarded as a material purpose of a trust: hence it may not be varied or terminated by consent of all of the beneficiaries, including the person for whose protection the provision was conceived.<sup>5</sup>

### The Uniform Trust Code

3.4 The Uniform Trust Code<sup>6</sup> contains provisions dealing with the modification or termination of non-charitable trusts.<sup>7</sup> In summary, these provide as follows:

- A trust may be modified or terminated by agreement among the trustor and all the beneficiaries, even if this is inconsistent with a material purpose of the trust.<sup>8</sup>
- A trust may be modified or terminated by agreement among all the beneficiaries if the court concludes, in the case of modification, that this is not inconsistent with a material purpose of the trust or, in the case of termination, that continuance of the trust is not necessary to achieve a material purpose.<sup>9</sup>
- A spendthrift provision is not presumed to constitute a material purpose.<sup>10</sup>
- If not all the beneficiaries consent to the proposed modification or termination, the court may approve it if satisfied (i) that if all beneficiaries had consented, the trust could have been modified or terminated; and (ii) the interests of a beneficiary who does not consent will be adequately protected.<sup>11</sup> The court may thus approve a

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<sup>4</sup> American Law Institute, Restatement (Third) of Trusts, section 65, General Comment (d) (Tentative Draft No 3, approved 2001), p 149.

<sup>5</sup> A result similar to that arrived at by Scots law with regard to alimentary interests.

<sup>6</sup> The Uniform Trust Code was produced in 2000 by the National Conference of Commissioners on Uniform State Laws (NCCUSL), a non-profit making body whose purpose is to draft model legislation for enactment in US states. It is based upon the American Law Institute Restatement (Third) of Trusts, and has been subject to revision in 2003 and further extensive amendment in 2004. To date it has been adopted in 15 states, usually with modifications (some of which are substantial). NCCUSL expects the adoption process to continue.

<sup>7</sup> Sections 410-412, reproduced in Appendix B to this discussion paper.

<sup>8</sup> *Ibid*, s 411(a). A possible variant permits this only with court approval.

<sup>9</sup> *Ibid*, s 411(b).

<sup>10</sup> *Ibid*, s 411(c). Following the 2004 amendment this provision is described as "optional". Several states which have enacted the Code have excluded this provision; in one (Pennsylvania), the presumption was reversed.

<sup>11</sup> *Ibid*, s 411(e).

variation where there are incapable, unborn or unascertained beneficiaries, and also where there is a non-consenting adult beneficiary.

A separate power is given to the court to modify or terminate a trust if, because of circumstances not anticipated by the truster, modification or termination will further the purposes of the trust, and may also modify the administrative terms of a trust if continuation on existing terms would be impracticable or wasteful or impair the trust's administration.<sup>12</sup>

3.5 The Code has been regarded by commentators as shifting the balance away from truster control by virtue of the fact that a spendthrift provision is not presumed to constitute a material purpose. Otherwise, however, the Code maintains the supremacy of the truster's wishes over those of the beneficiaries together. A rather different approach is taken by the California Probate Code, which permits variation by all the beneficiaries together on application to the court unless inconsistent with a material purpose of the trust, in which case the court has a discretion to determine whether the reasons for the variation outweigh the interest in accomplishing a material purpose of the trust.<sup>13</sup> Consent on behalf of an incapable, unborn or unascertained beneficiary may be given by a guardian *ad litem* who may, in determining whether to give consent, "rely on general family benefit accruing to living members of the beneficiary's family as a basis for approving a modification or termination of the trust".<sup>14</sup> The balancing process required here would, for example, permit the court to weigh the impact of taxation which the truster may not have foreseen against the latter's presumed wish to have his dispositions implemented.

3.6 Despite these movements, the principle underlying the US approach remains that the wishes of the truster take precedence over the combined will of the beneficiaries. No distinction is made between the situation where the truster is still alive and unwilling to consent to the beneficiaries' scheme, and the situation where the truster is dead or otherwise unable to consent. Critics of this approach refer to it as "dead hand control" and argue that a rule which originated at a time when the pace of change was slower than it is today is insufficiently flexible to meet modern needs. Supporters of the approach emphasise the entitlement of the truster to specify the basis upon which benefit from the trust will be enjoyed without the risk of his scheme being dismantled either during his lifetime or after his death in order to permit immediate and possibly irresponsible distribution of the trust capital.

### Other jurisdictions

3.7 The "material purpose" doctrine has found little favour outside the United States. It has been adopted in two Canadian provinces, where legislation has been passed abrogating the rule in *Saunders v Vautier*.<sup>15</sup> A similar reform was recommended by the Ontario Law Reform Commission,<sup>16</sup> but the recommendation was not accepted and subsequent legislation in Ontario retained provisions similar to English law.<sup>17</sup> In South Australia the court must be satisfied that the proposed exercise of its powers "would not disturb the trust beyond what is necessary to give effect to the reasons justifying the exercise of the powers",

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<sup>12</sup> *Ibid*, s 412.

<sup>13</sup> California Probate Code, s 15403.

<sup>14</sup> *Ibid*, s 15405.

<sup>15</sup> Trustee Act 1980 (Alberta), s 42; Trustee Act (Manitoba), s 61.

<sup>16</sup> *Report on the Law of Trusts* (1984), ch 7.

<sup>17</sup> Variation of Trusts Act (RSO 1990, ch V 1).

and "accords as far as reasonably practicable with the spirit of the trust".<sup>18</sup> The Uniform Law Conference of Canada, other Canadian provinces, and Commonwealth jurisdictions elsewhere, have retained the English approach. The Law Reform Commission of Ireland has recently recommended enactment of legislation along the lines of the English statute, rejecting arguments in favour of the approach in the United States.<sup>19</sup>

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<sup>18</sup> Trustee Act 1936, s 59C(3)(c) and (d).

<sup>19</sup> Report on *The Variation of Trusts* (LRC 63), 2000, ch 2.

## Part 4            Proposals for reform: extra-judicial variation and termination

### The policy issue

4.1 In this part of the Discussion Paper we consider possible reforms of the law regarding variation or termination of trusts without the need for judicial approval. It is, however, first necessary to address an underlying policy issue which is common to extra-judicial variations and variations requiring judicial approval, namely the question whether the will of the truster or the will of the current beneficiaries ought to predominate. Accordingly, much of the following discussion is also relevant to our discussion of judicial approval of variation or termination of trusts in Part 5 below.

4.2 As Scots law presently stands, there is consistency between the common law relating to extra-judicial termination of trusts and the judicial approval procedure contained in section 1 of the Trusts (Scotland) Act 1961. The common law proceeds upon the basis that if all beneficiaries consent to the termination of the trust or (though as discussed above authority is less clear on this) to the variation of the terms upon which the trust property is held, there is no-one (not even the truster) with an interest to object. The 1961 Act proceeds upon the same basis and extends it, with the court supplying approval on behalf of beneficiaries who are incapable of consenting, on being satisfied that no prejudice will be sustained by such beneficiaries. The truster is entitled to be heard but has no power of veto of the beneficiaries' proposed scheme.

4.3 A stark example of the consequences of this approach, in the context of judicial variation, is afforded by the English case of *Goulding v James*.<sup>1</sup> The testatrix had bequeathed the residue of her estate to her daughter for life, with the remainder<sup>2</sup> to the testatrix's grandson, contingently upon his attaining age 40, which failing to the grandson's issue. There was evidence that the testatrix had made the bequest in this form because she distrusted her son-in-law and wished to ensure that he could not obtain control of the capital. The daughter and grandson, both of whom were of full age, sought approval of a variation in terms of which the capital would be divided between them absolutely, subject to retention of a fund for the grandson's unborn issue, to cover the contingency of his failing to survive to age 40. At first instance, Laddie J refused to approve the arrangement on the ground that it would offend against the truster's clear wishes. The Court of Appeal held that the truster's intentions and wishes had no relevance to the question for the court which was simply whether or not there was benefit to the unborn beneficiaries on whose behalf approval was sought.<sup>3</sup>

4.4 An application to court was necessary in *Goulding v James* because the grandson's interest was contingent and therefore there were other interests (those of his unborn issue)

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<sup>1</sup> [1997] 2 All ER 239.

<sup>2</sup> I.e. the fee, in Scots terminology.

<sup>3</sup> Similar decisions have been given by the Court of Appeal in British Columbia: *Sandwell & Co Ltd v Royal Trust Corp of Canada* (1985) 17 DLR (4<sup>th</sup>) 337; *Russ v British Columbia (Public Trustee)* (1994) 89 BCLR (2d) 35.

which required to be protected. Had the grandson had a *vested* interest in the fee, subject only to his mother's life interest then, following the English equivalent of the rule in *Miller's Trustees*, the daughter and grandson could simply have agreed between themselves to terminate the trust and divide the fund.<sup>4</sup> The policy issue which arises is whether there is a need for any additional restrictions to be put in place, along the lines of the American provisions described in Part 3, to prevent beneficiaries from disturbing the truster's scheme in this way, at least without some court involvement. It seems likely that if the facts of *Goulding v James* had come before an American court, approval of the termination of the trust would have been refused on the ground that continuance of the trust was necessary in order to achieve a material purpose, namely to prevent the fund falling into the hands of the mistrusted son-in-law. The US approach would also accord with the dissenting view of Lord Young in *Miller's Trustees*.<sup>5</sup>

4.5 The principal ways in which the US approach differs from the Scottish (and English) approach are as follows. Under the US approach:

- Unless the truster consents, court approval is required even if all the beneficiaries are of full age and consent.
- The need to consider whether the proposal is inconsistent with a material purpose of the trust secures a continuing influence by the truster on the terms of the trust, perhaps many years after his or her death.
- No distinction is drawn between minor, unborn, unascertained, untraceable and non-consenting adult beneficiaries: in all cases, the court must be satisfied that their interests are "adequately protected".

In effect, the US court is approving the variation generally, rather than considering it merely from the point of view of certain specific, incapable persons.

4.6 Although the current Scottish approach and the US approach have different starting points, neither is absolute in its preference of one interest over the other. Not all purposes are regarded by US law as "material", requiring continuance against the wishes of the beneficiaries. Equally, Scots law has always recognised that a truster may declare certain types of interest to be alimentary, thereby preventing renunciation in pursuance of an agreement among beneficiaries without court authorisation under section 1(4) of the 1961 Act. The question is whether, as a matter of policy, there is a need for the introduction of further restrictions on the circumstances in which trusts may be brought to an end or modified in pursuance of an agreement among beneficiaries.

4.7 As noted above,<sup>6</sup> the US approach draws no distinction between a truster who is alive and capable of consenting (but does not consent) to a termination or modification of the trust and a truster who is dead or otherwise incapable of consenting: in both cases court approval is necessary before the beneficiaries can alter the trust provisions by agreement. One possibility would be to restrict the need for court approval to the situation where the truster positively refuses to consent. Another possibility would be to require court consent if

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<sup>4</sup> The mere fact that the grandson's interest was not vested would not of itself have precluded variation by agreement if all interests, vested or otherwise, had been held by persons of full age.

<sup>5</sup> See para 2.2 above.

<sup>6</sup> Para 3.6.

the trust has been in existence for less than a specified period such as 20 years. On balance we consider that such distinctions would be anomalous. If, as a matter of policy, the trustor's wishes are to receive preference over the desires of the beneficiaries, then it seems to us that this ought to be so regardless of whether the trustor is still alive or the lapse of time since the trust began.

4.8 As we have noted, the question whether there is a need to accord greater weight to the wishes of the trustor is one of policy. Our provisional view is that there is no such need. In many cases, when all possible beneficiaries are of full age and capacity, this will be a strong indication that the trust purposes have run their course, so that there is no merit in prolonging the trust unnecessarily or of requiring the beneficiaries to incur the expense of a court application in order to bring it to an end. There are, however, circumstances in which one of the trustor's purposes is to protect the interest of a beneficiary against himself, or against the risk of loss to a third party such as a creditor or a former spouse. We consider it desirable that a trustor should be able to impose restrictions which provide effective protection in those circumstances, but in our view the present law affords sufficient scope for this. So far as trust capital is concerned, some degree of protection can be obtained by postponing vesting in capital. For example, in the common (and tax-efficient) situation of an accumulation and maintenance trust, vesting in a beneficiary is postponed until attainment of a specified age not exceeding 25. This is likely to preclude variation or early termination by extra-judicial agreement among beneficiaries because there will probably be unborn or unascertained beneficiaries with an interest contingent upon the primary beneficiaries failing to survive to age 25. But, as *Goulding v James* demonstrates, the trustor's wishes can still be overcome in such cases by means of an application to the court. In order to avoid even this possibility, ultimate disposal of the trust capital may be left to the discretion of the trustees or, alternatively, made subject to a power of appointment exercisable by a beneficiary on death in favour of a specified class such as his or her issue. As regards income, a beneficiary's right may be limited to an alimentary interest in order to restrict the possibility of attachment by or assignation to creditors or a former spouse. In all such cases termination by agreement among beneficiaries would not be competent.<sup>7</sup>

4.9 In any event, in view of the lack of specific authority on the ability of beneficiaries of full age to agree to vary the terms of the trust (as opposed to demanding that the trust property be made over to them absolutely), we consider that it would be desirable for the rule to be given statutory expression. We invite comment on the following proposal:

1. **It should be confirmed by statute that where all the persons with an interest, whether vested or contingent, in property held in trust are of full age and capacity, they may agree, without the need to obtain court approval of the agreement, either:**
  - (a) **to vary the purposes for which the trust property is held; or**
  - (b) **to terminate the trust and to require the trustees to make over the trust property to them in such shares as they may agree.**

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<sup>7</sup> If, for example, the interest of the testatrix's daughter in *Goulding v James*, discussed above, had been an alimentary liferent under Scots law, the court could not have approved the arrangement dividing the trust capital without having been satisfied that in all the circumstances it was reasonable to do so.

Under the present law, there would continue to be no requirement that the trustee, if alive, consent to the variation or termination. If, however, an interest had been declared by the trustee to be alimentary, variation or termination by agreement would continue to be excluded.

### **Consent to extra-judicial variation on behalf of a child**

4.10 The statutory expression of the rule in *Miller's Trustees* which is proposed in paragraph 4.9 above would permit extra-judicial termination only where all the persons with an interest in the trust were of full age and capacity. It would not apply where there is a beneficiary with a vested or contingent interest who is under age. This reflects the current position in terms of which the approval of the court is sought on behalf of minor beneficiaries as well as unborn and unascertained beneficiaries. We now address the question whether a parent or other legal representative should have capacity to consent to an extra-judicial variation on behalf of a child.

4.11 Under the Children (Scotland) Act 1995, a parent has responsibility to act as legal representative in relation to his or her child.<sup>8</sup> As such, the parent has power to administer any property belonging to the child and to act in or give consent to any transaction where the child is incapable of so acting or of consenting on his own behalf.<sup>9</sup> "Transaction" is defined as in the Age of Legal Capacity (Scotland) Act 1991, and includes the giving by any person of any consent having legal effect and the taking of any step in civil proceedings.<sup>10</sup> When acting as legal representative, the parent is obliged to act as a reasonable and prudent person would act on his own behalf and is liable to account to the child for his intromissions with the child's property. Subject, however, to those duties and to the terms of any court order in relation to the exercise of parental responsibilities and rights, the parent is entitled to do anything which the child, if of full age and capacity, could do in relation to that property.<sup>11</sup> On one view, therefore, by the 1995 Act a parent has already been given statutory power to consent on behalf of his or her child to the termination or variation of a trust. The opposite view is taken by Wilkinson and Norrie,<sup>12</sup> who list two powers which they regard legal representatives as lacking in relation to a child's property: the power to make a will and the power to consent to a variation of trust purposes. This latter exception is considered by the authors to follow from section 1(2) of the 1961 Act which deems persons aged between 16 and 18 to be incapable of consenting without court approval.<sup>13</sup> They regard it as implicit so far as children *under* the age of 16 are concerned that legal representatives lack the necessary power to consent to a variation without court approval. In practice, applications continue to be made to the Court of Session for approval of trust variation arrangements on behalf of children under 16. We are not aware of any variations which have proceeded extra-judicially utilising a legal representative's powers under the 1995 Act.

4.12 If it is the case that the powers of a legal representative of a child under 16 do not extend to consenting to a trust variation on behalf of the child, then this would appear to us to be anomalous. There is in our view no qualitative distinction to be made between this

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<sup>8</sup> Children (Scotland) Act, s 1(1)(d). A guardian has the same power under s 7(5).

<sup>9</sup> *Ibid*, s 15(5).

<sup>10</sup> *Ibid*, s 15(1); Age of Legal Capacity (Scotland) Act 1991, s 9.

<sup>11</sup> *Ibid*, s 10(1).

<sup>12</sup> *Parent and Child* (2<sup>nd</sup> edn, 1999), paras 15.57–15.58.

<sup>13</sup> As amended by the Age of Legal Capacity (Scotland) Act 1991, Sch 1, para 27 and Sch 2. See also *ibid* s 1(3)(f)(iii), preserving the practice of appointing a curator *ad litem* to persons aged 16 and 17.

type of "transaction" and others to which a legal representative has power to consent. For example, we understand it already to be generally accepted that legal representatives have power to execute extra-judicial post-death deeds of variation on behalf of their children.<sup>14</sup> There is a strong case for making clear that there is no general exception in this regard to the powers of legal representatives. The effect of such clarification would be to confirm that it is unnecessary to apply to the court for approval in any case where the only obstacle to extra-judicial agreement is the existence of a child under 16. Application to court would remain necessary in cases where, in addition to or instead of a child under 16, there were unborn or unascertained persons with an actual or contingent interest in the trust. The expense of appointing a curator *ad litem* to the child under 16, and of instructing representation of the curator *ad litem* at the hearing, could be saved. However, statutory confirmation of the right of a legal representative to consent on behalf of a child could give rise to a variety of concerns.

### *Conflicts of interest*

4.13 The first of these concerns is that in many schemes for variation or termination of a trust there is a conflict of interest between the child and his or her legal representative. The primary purpose of the variation might, for example, be to release capital from the trust fund to the legal representative in his or her individual capacity. Under the present law,<sup>15</sup> the court must be satisfied that to do so will not be prejudicial to the interest of a child who might, say, have a contingent interest in the trust capital in the event of the parent/legal representative dying before attaining a specified vesting age, such as 35 or even 50 or 60. At this stage, it is convenient to explain the usual way in which the child's interest is protected in such circumstances.<sup>16</sup> The child's interest is actuarially valued as a percentage of all the interests in the trust estate. A fund is then set aside which corresponds to that percentage, on terms which assure payment of that fund to the child on an appropriate date.

#### *Example*

Property is held in trust for A, in terms of which A will receive the income until he attains the age of 35, at which time he will become entitled to the trust capital. If A dies without attaining 35, the trust fund is to be held for his children B and C. A is presently aged 29, and wishes to terminate the trust early.

The interest in the trust of B and C together (which will emerge if A dies before reaching 35) is actuarially valued at, say, 5% of all interests in the trust. The practice of the court is to approve an arrangement providing for early payment to A, provided that a fund is retained, amounting to at least 5% of the value of the trust fund, which will be held for (or paid over to) B and C on A's death, whether or not this occurs before A has reached age 35. In other words, a 5% chance of succeeding to the whole fund is exchanged for a certain future entitlement to a 5% share of the fund.

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<sup>14</sup> Extra-judicial deeds of variation are deeds by which the distribution of property in a person's estate at death is altered by agreement among the beneficiaries. Provided that this is done within two years after the date of death, the estate may be treated for inheritance tax and/or capital gains tax purposes as if the amended distribution had been effected by the deceased. This is frequently used to achieve tax savings. The capacity of legal representatives to execute such deeds on behalf of children is accepted by, among others, the Inland Revenue.

<sup>15</sup> Section 1(1) of the 1961 Act.

<sup>16</sup> It was at one time the practice to protect the child's interest by insurance against the contingency which would result in the emergence of the interest. In recent years, however, all insurance companies have withdrawn from this market and it is not currently practicable to obtain such insurance.

4.14 The duties imposed by section 10 of the 1995 Act<sup>17</sup> would of course apply when a legal representative gives consent to a trust variation. We imagine that the test in section 10(1)(a) (requirement to act as a reasonable and prudent person would act on his own behalf) would, for example, be satisfied where the legal representative gives consent to any arrangement which the court would approve were its approval required. If, in our example,<sup>18</sup> the "retained fund" procedure were to be followed by A as his children's legal representative, it seems unlikely that his estate could be called to account by B or C for any loss sustained by them in the event of A failing to survive until he reached 35. The policy question for consideration is whether something more is required to protect the child against irreparable financial loss arising from a breach by the legal representative of his or her duty to the child.

4.15 One view would be that the protections afforded to a child by the 1995 Act in relation to the actings of the legal representative afford no less adequate protection in relation to trust variations than they do in relation to other intrusions by the legal representative with the child's property. Those protections are (i) the specification of the standard of care required by the legal representative, and (ii) the obligation to account to the child on demand after the child has attained full age. On the other hand, not all situations in which a parent is required to administer a child's property are as likely to give rise to a conflict of interest as is the variation of a family trust. We have considered a range of possible approaches:

(i) make no specific legislative provision for consent to be given to a trust variation by a legal representative on behalf of a child other than to make clear that such a course of action is competent under the present law.

(ii) make legislative provision for consent to be given by a legal representative subject to the latter being satisfied regarding the same matters as to which the court would require to be satisfied. Thus if, for example, the present test for court approval were to be retained, it would also be specified in legislation that before consenting on behalf of a child a legal representative would require to be satisfied that the proposed scheme was not prejudicial to the child. This alternative would have the benefit of clarifying the scope of the legal representative's duty but would still permit consent to be given in circumstances where a conflict of interest exists.

(iii) make legislative provision for consent to be given by a legal representative but only where no conflict exists between the interest of the child and the interest of the legal representative in a personal capacity. Defining the circumstances in which a conflict of interest exists could prove problematic. There will be many circumstances where, as a matter of economic reality, there is no conflict: for example, where the effect of a variation is to postpone vesting in a parent, rendering it more likely than before that the capital will eventually pass to the child rather than the parent. It would, however, be difficult to devise a statutory definition of conflict of interest which distinguished between this situation and one where, say, a scheme provided for the parent to receive payment of a capital sum which was less than the actuarial value of his or her interest, leaving the balance in trust for the child. Perhaps the only workable approach would be to treat a conflict of interest as existing in all cases in which both the parent and the child had interests as beneficiaries of the trust. Even this would not be exhaustive of the circumstances in

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<sup>17</sup> See para 4.11 above.

<sup>18</sup> See para 4.13 above.

which a conflict could exist. A variation which provided for trust monies to be released for the benefit of a child (eg for payment of school or university tuition fees) could benefit the child's parents indirectly by relieving them of a financial burden which they would otherwise have undertaken personally.

(iv) make legislative provision for consent to be given by a legal representative in all circumstances (ie as options (i) or (ii) above), but for the approval of the trustees (including at least one trustee who has no interest as a beneficiary in the trust) to be required in any case where a conflict exists between the interest of the child and that of the legal representative. This ought, at least in trusts where there is one or more disinterested trustee, to ensure that the legal representative could not abuse his or her power of consent to the child's detriment. There remains the risk, however, that the legal representative would be able to influence the view of the disinterested trustee, especially if the latter were another member of the family. A variant of this option, which would address the difficulty of influence, would be to make legislative provision for the legal representative's consent to be approved by the Accountant of Court. It might be thought, however, that there is little advantage in a statutory regime requiring the approval of the Accountant of Court when compared with the present system which requires the approval of the court itself.

4.16 A further difficulty which we have considered is that of the consequence of an extra-judicial variation having proceeded on the basis of the consent of a legal representative given improperly, for example consent given under option (iii) above by a parent who in fact did have a conflict of interest. In such a case the variation could be (a) void; (b) voidable at the instance of an interested party, including the child on attaining full age; or (c) effective, subject to a personal right of action by the child against the parent for any loss sustained as a result of the implementation of the arrangement. The disadvantage of the variation being either void or voidable is that it may be difficult or impossible to reverse the arrangement after implementation.<sup>19</sup> The disadvantage of giving the child only a personal right against the parent is that it may prove to be worthless. However, these are the same difficulties which can arise in many situations where it is sought to reduce a formal transaction or agreement including an extra-judicial variation by consent where all beneficiaries are of full age. It may be that it is acceptable for the beneficiary simply to have to select the appropriate remedy in the circumstances of a particular case, according to existing legal principles.<sup>20</sup>

4.17 Permitting consent to be given by a legal representative on behalf of a minor beneficiary would go further in facilitating extra-judicial trust variation and termination than has hitherto been done in any of the other jurisdictions which have enacted a trust variation procedure based on the English model. However, we consider that it is the natural consequence of the reforms to Scots law which were effected by the Children (Scotland) Act 1995. We invite comment on the following questions:

- 2. (1) Should legal representatives have power to consent to a variation or termination of a trust on behalf of a child who is incapable of consenting on his own behalf?**

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<sup>19</sup> For a discussion of those difficulties in a slightly different context, see para 4.21 below.

<sup>20</sup> An analogy may be drawn with a beneficiary's remedies for breach of trust. As noted in our Discussion Paper on *Breach of Trust*, at para 2.3, the remedy may, depending on the circumstances, consist of recovering property, requiring restoration of its value, or damages.

**(2) If so, is there a need for protection of a child against the actings of a legal representative with a conflict of interest; for example**

- (a) by specifying the matters in respect of which the legal representative would require to be satisfied before giving consent?**
- (b) by excluding the possibility of such consent where there is a conflict of interest between the child and the legal representative?**
- (c) by permitting such consent where there is a conflict of interest only where the arrangement is also consented to by the trustees, including at least one disinterested trustee?**
- (d) by requiring approval of the variation by the Accountant of Court?**
- (e) by some other means?**

**(3) If option (c) were to be chosen, is there a need to specify the remedy available to a child where a variation proceeds on the basis of the consent of the legal representative, despite the existence of a conflict of interest?**

#### *Payment to a minor beneficiary*

4.18 If extra-judicial variation – or, more particularly, termination – is permitted of a trust with beneficiaries aged under 16, a consequence could be the distribution of trust capital to a child. For example, assume that property is held for D in life and for her son E (aged 8) in fee, with no remoter contingent interests. The interests of D and E are actuarially valued at 75% and 25% of the fund respectively. D wishes to terminate the trust and, consenting on behalf of E, demands that the trustees pay 50% of the fund to her as an individual and 50% to her as legal representative of E. This situation could not have occurred prior to the 1995 Act because the rule at common law in *Miller's Trs* has no application if there is a beneficiary who is not of full age and capacity. Arithmetically there is no prejudice to E because he is receiving substantially more than his actuarial share of the trust fund. A concern might arise if E's share, which may be substantial, were being paid out by the trustees to be held by a parent, guardian or other person, where it was at risk of dissipation or insolvency.

4.19 Safeguards are, however, provided by the Children (Scotland) Act 1995. Where property exceeding £5,000 in value is held for a child by a person other than a parent or guardian, the holder (including a trustee) may apply to the Accountant of Court for a direction as to the administration of the property.<sup>21</sup> If the holder is a trustee or executor and the value of the property exceeds £20,000, application for a direction is compulsory.<sup>22</sup> These

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<sup>21</sup> Children (Scotland) Act 1995, s 9(3).

<sup>22</sup> *Ibid*, s 9(2). There is an exception in s 9(4) where the parent or guardian has been appointed a trustee under a trust deed to administer the property concerned: in this situation the holder must simply transfer the property to the parent or guardian.

safeguards would apply to an extra-judicial variation or termination of trust which resulted in a capital sum becoming due to a child absolutely. Accordingly, in any case in which the sum due to the child exceeds £20,000, the trustees will be bound to apply to the Accountant of Court for a direction. If there is any doubt as to the parent's ability to administer the sum, or as to his or her financial security, then an appropriate direction could be made. It therefore appears to us that the existing law deals adequately with this situation, and we do not propose the introduction of any additional safeguards.<sup>23</sup>

### *Beneficiaries aged 16 or 17*

4.20 It is also necessary to revisit the situation of 16 and 17 year olds. As noted above,<sup>24</sup> a person aged 16 or 17 is presently deemed to be incapable of consenting to an arrangement varying or terminating a trust. Clearly it would be anomalous if the need for application to the court could be avoided where all of the beneficiaries were under 16, but could not be avoided where some were aged 16 or 17. The rationale behind the relevant provisions of the Age of Legal Capacity (Scotland) Act 1991 (including the amendments which that Act made to section 1 of the 1961 Act) is to be found in our Report on the *Legal Capacity and Responsibility of Minors and Pupils*,<sup>25</sup> as follows:

"...We had some doubt about our original suggestion to exclude the right of challenge by 16 and 17 year olds in respect of their own consent to variation. It seemed to us that this could give rise to anomalies. The court, in giving approval on behalf of beneficiaries under 16, would be directed to take account of the risk of prejudice to such beneficiaries but the possibility of prejudice to 16 and 17 year old beneficiaries would be irrelevant to the validity of their consent. Given the shape of our final recommendations, the principled approach would be to allow 16 and 17 year olds to give their own consent to variation but that consent would be open to challenge on the ground of substantial prejudice or could be ratified by a court in order to preclude challenge. Moreover, if the consent of a 16 or 17 year old beneficiary were to be open to challenge and hence also to ratification by a court, it would be odd to allow for ratification by the sheriff court in summary procedure whereas approval on behalf of beneficiaries under 16 could be given only by the Inner House of the Court of Session.

In the end we have concluded, along with most commentators, that the sensible solution is to keep the existing provision in the 1961 Act. This is, in our view, more practicable than trying to rely on the general rule of capacity at 16 coupled with the right of challenge and so on. It has the advantage of dealing with the question of prejudice to all beneficiaries under 18 in the same proceedings."

4.21 It can be seen from this passage that one of the reasons for retaining the requirement of court approval on behalf of 16 and 17 year olds was to maintain consistency with the position regarding children under 16. Now, however, we are inviting comment on a proposal to render court involvement unnecessary in relation to children under 16. For 16

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<sup>23</sup> There is a further provision in s 13 of the 1995 Act, which applies where in any court proceedings a sum of money is payable to or for the benefit of a child under 16. The court may make such order relating to the payment and management of the sum for the benefit of the child as it thinks fit and may, in particular, order that the sum be held by a judicial factor, or order it to be paid to the sheriff clerk or Accountant of Court, or to a parent or guardian of the child, to be invested or applied for the benefit of the child. We are, however, dealing here with a situation in which the trust is being varied or terminated without court involvement and so the safeguards in s 13 are not applicable.

<sup>24</sup> For a summary of the present position, see para 2.14 above.

<sup>25</sup> Report No 110 (1987), paras 4.4 and 4.5. There was no discussion of this issue during the Parliamentary Debates on the Bill which became the Age of Legal Capacity (Scotland) Act 1991.

and 17 year olds, it seems to us that what was described in 1987 (see above) as "the principled approach" now becomes even more attractive. Beneficiaries aged 16 or 17 would give (or indeed refuse) their own consent to the variation. A difficult issue still arises as to whether such consent should be open to challenge by a beneficiary after attaining the age of 18,<sup>26</sup> and hence also to ratification.<sup>27</sup> On the one hand, the sums involved in trust variations will often be significantly higher than those at stake in many transactions which are capable of being set aside. The beneficiary may not have had the benefit of separate advice. On the other hand, trust variations may be very difficult to unravel after they have been implemented following agreement or court approval. A vesting date or other event may have passed which, had the variation not taken place, would have had irrevocable consequences for beneficiaries, including tax consequences. The trustees may have distributed capital which could be very difficult to recover from the recipients. There is therefore an argument for excluding the right of challenge as is, currently, the position in relation to the taking of any step in civil proceedings.<sup>28</sup> One way of protecting the beneficiary might be to require the trustees to be satisfied that the beneficiary has received proper independent advice before taking any action in implementation of the variation to which the beneficiary has consented. Alternatively, if approval by the Accountant of Court of consent on behalf of beneficiaries under 16 were required, such approval could also be required of consent by beneficiaries aged 16 or 17. We invite comment on the following proposal and questions:

- 3. (1) Beneficiaries aged 16 or 17 should have full capacity to consent to the variation or termination of a trust.**
- (2) (a) Should the right of challenge, after attaining age 18, of a beneficiary aged 16 or 17 at the time of consent be excluded?**
- (b) Should the trustees be required to satisfy themselves that a beneficiary aged 16 or 17 has received independent advice?**
- (c) Alternatively, should approval by the Accountant of Court of the beneficiary's consent be required?**

### **Consent to extra-judicial variation on behalf of adult beneficiaries with incapacity**

4.22 Section 1 of the 1961 Act provides for court approval of a trust variation on behalf of any beneficiary who is incapable of assenting "by reason of nonage or other incapacity". It is therefore competent for the court to approve an arrangement on behalf of an adult who lacks the capacity to give his or her consent. Alternative methods of obtaining consent on behalf of an incapable adult have, however, been available since the entry into force of the Adults with Incapacity (Scotland) Act 2000. An order appointing a guardian to an adult may confer upon him power to deal with such particular matters in relation to the property, financial

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<sup>26</sup> Under the 1991 Act, s 3, which permits a person aged under 21 to apply to the court to set aside a transaction entered into when he was 16 or 17 on the ground that it was a "prejudicial transaction", ie one which an adult, exercising reasonable prudence, would not have entered into and which has caused or is likely to cause him substantial prejudice.

<sup>27</sup> On application to the sheriff under s 4 of the 1991 Act by all parties to a proposed transaction with a 16 or 17 year old.

<sup>28</sup> 1991 Act, s 3(3)(d). The question of ratification in applications which are in any event before the court for other reasons is discussed in para 5.26 below.

affairs or personal welfare of the adult as may be specified in the order<sup>29</sup> or, alternatively, power to manage the property or financial affairs of the adult more generally.<sup>30</sup> By virtue of his appointment, the guardian has power to act as the adult's legal representative.<sup>31</sup> Another possibility created by the 2000 Act is that an intervention order may be granted authorising the appointee to take such action in relation to the adult's property, financial affairs or personal welfare as is specified in the order.<sup>32</sup> Either of these routes could be used to enable consent to a variation to be given on behalf of the adult without the need for an application under the 1961 Act (although there will of course have to have been a prior court application to obtain the guardianship or intervention order). A further possibility is that power to consent to a trust variation could have been given, prior to the adult becoming incapable, to a continuing attorney whose power of attorney is registered with the Public Guardian.<sup>33</sup>

4.23 In the light of the availability of these options, we do not consider that there is any need to propose further amendment to the law to enable variations requiring the consent of an adult with incapacity to proceed without court involvement. The question of whether to retain the alternative of seeking court approval under the 1961 Act is considered below.<sup>34</sup>

#### **Extra-judicial variation or termination of alimentary liferents**

4.24 Under the present law an alimentary liferent (or other alimentary interest) may not be varied or terminated after the liferenter has entered into possession without the authorisation of the court under section 1(4) of the 1961 Act.<sup>35</sup> We have considered whether to propose that such authorisation should no longer be required for the liferenter to agree, along with the other beneficiaries, to bring an alimentary liferent to an end, or to vary it, or to remove the alimentary restriction. The effect of such a change would be to render the alimentary protection revocable at the will of the beneficiaries, which would often be contrary to the wishes of the truster who thought fit to declare the liferent to be alimentary when the trust was created. We have concluded that such a change is not desirable. One of our reasons for proposing that Scots law should not follow the US "material purpose" doctrine was that a Scottish truster has at his disposal the facility of creating an alimentary liferent in circumstances where he wishes to protect a beneficiary from creditors or a former spouse or, indeed, from himself.<sup>36</sup> It seems to us that the alimentary liferent continues to have a role to play and we do not wish to propose a change which would have the effect of hastening its demise. With one exception, therefore, we do not propose legislative change which would permit the termination or variation of trust provisions creating an alimentary liferent, including the removal of an alimentary restriction, without court authorisation.

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<sup>29</sup> Adults with Incapacity (Scotland) Act 2000, s 64(1)(a).

<sup>30</sup> *Ibid*, s 64(1)(d).

<sup>31</sup> *Ibid*, s 64(3). Adrian Ward, *Adult Incapacity*, (2000), para 10-42 expresses the view that child law may, with appropriate caution, be a source of guidance as to the scope of "legal representation" in relation to adults with incapacity.

<sup>32</sup> *Ibid*, s 53(1), (5).

<sup>33</sup> *Ibid*, s 19.

<sup>34</sup> See para 5.25.

<sup>35</sup> See further paras 2.16 – 2.19 above.

<sup>36</sup> See para 4.8 above.

4.25 The exceptional case where we consider that it might be desirable to permit variation or termination without court approval is that of alimentary liferents created, prior to 1984,<sup>37</sup> by a woman in favour of herself in an ante-nuptial marriage contract. As time passes there will be fewer and fewer of such liferents as it is no longer competent to impose an alimentary restriction in these circumstances. The rationale behind this exception to the general rule that a person may not create an alimentary restriction in his own favour was discussed by Lord President Clyde in *Douglas Hamilton v Duke and Duchess of Hamilton's Trustees*,<sup>38</sup> namely to ensure that a wife's property did not fall under her husband's *jus mariti* and *jus administrationis*. This rationale is long obsolete. In a series of cases it was held that, in absence of clear words to the contrary, such a liferent ceased to be alimentary after the death of the husband, whether or not there were surviving issue of the marriage.<sup>39</sup> It seems to us that there is now no benefit in requiring court authorisation of the variation or termination of an alimentary liferent which was created by a wife in favour of herself, as opposed to having been created by a third party in her favour, even where the marriage continues to subsist. We invite comment on the following proposal:

4. **Where a woman who, prior to 1984, created an alimentary interest in her own favour in an ante-nuptial contract of marriage wishes to vary or terminate that interest, authorisation by the court under section 1(4) of the Trusts (Scotland) Act 1961 should no longer be required.**

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<sup>37</sup> I.e. prior to the change in law made by the Law Reform (Husband and Wife) (Scotland) Act 1984, s 5: see para 2.17.

<sup>38</sup> 1961 SC 205: for the dictum in question see para 2.17 above.

<sup>39</sup> *Dempster's Trs v Dempster* 1949 SC 92; *Sturgis's Trs v Sturgis* 1951 SC 637; *Neame's Trs v Neame* 1956 SLT 57; *Strange & Anor, Petitioners* 1966 SLT 59; *Pearson & Ors, Petitioners* 1968 SLT 46. The converse situation is where the alimentary provision is for the children of the marriage as well as the wife: see eg *Sutherland & Ors, Petitioners* 1968 SC 200.

# Part 5            Judicial approval of variation or termination of private trusts

## Introduction: the policy issue

5.1     In this Part we consider a variety of possible reforms to the law presently contained in section 1(1) of the Trusts (Scotland) Act 1961 regarding judicial approval of arrangements varying or terminating private trusts. These are mostly intended to address difficulties which arise from time to time in the practical operation of section 1(1), and our proposals would extend the circumstances in which an application to court for approval of the variation or termination of a trust could be made. It should be noted that two matters concerning section 1 have already been addressed in our Discussion Paper on *Trustees and Trust Administration*, namely transfer of applications from the Inner House to the Outer House<sup>1</sup> and the use of section 1 to alter the trustees' powers of management and administration.<sup>2</sup>

5.2     The same underlying policy issue arises in relation to judicial approval of variation as in relation to extra-judicial variation by agreement: should the combined will of the beneficiaries, supplemented by court involvement on behalf of unborn and unascertained beneficiaries (and possibly also incapable beneficiaries), continue to take precedence over the will of the truster? Alternatively, should the present law be amended to require the court to consider the proposed arrangement not only from the point of view of prejudice to beneficiaries who cannot consent to it, but also from the point of view of inconsistency with a material purpose of the truster?

5.3     In Part 4 above, we expressed the provisional view that the material purpose doctrine should not be introduced in relation to variation of trusts by extra-judicial agreement. It would be illogical to introduce it in relation to court applications if it was not applied to extra-judicial variations. We are not satisfied that there is a need for it in relation to court applications. Very few applications under section 1 of the 1961 Act attract opposition. There has as yet been no reported Scottish case similar to *Goulding v James*.<sup>3</sup> We are not aware of any cases in which a truster, or other person, would have wished to oppose an application for variation on the ground of inconsistency with the truster's desires but has been prevented from doing so by the absence of such a ground in the present section 1. The circumstances in which a truster's wishes ought to prevail over those of the beneficiaries taken as a whole are, in our view, limited. They will tend, as in the United States, to involve an adult beneficiary whose ability to manage a sum made over to him or her absolutely is in doubt. In such cases the truster has available to him the possibilities of an accumulation and maintenance trust with vesting of capital dependent upon the exercise of a power of appointment by the trustees; a discretionary trust; or the creation of an alimentary interest.

5.4     A further, and more radical, alternative would be to abandon the current statutory framework altogether and to replace it with legislative provisions modelled on those

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<sup>1</sup> See Discussion Paper No 126, para 5.52 and Proposal 24(2).

<sup>2</sup> *Ibid*, paras 5.35–5.38 and Proposal 23.

<sup>3</sup> [1997] 2 All ER 239; see para 4.3 above.

provisions presently applicable to public trusts.<sup>4</sup> Applied to private trusts, the effect of these provisions could, for example, be to empower the court to approve a variation on behalf of all non-consenting beneficiaries (whether minor, unborn, unascertained, untraceable or simply refusing to consent), if satisfied (a) that their interests were adequately protected, and (b) that the variation would enable the trust fund to be used to greater advantage for the beneficiaries as a whole, even if this was inconsistent with a particular trust purpose. A new statutory criterion for approval, such as the needs and wishes of the beneficiaries at the time when the application is made, would require to be devised.

5.5 It is not immediately obvious that such a radical change in the legislation would bring about advantages which cannot be obtained by the amendments which we propose within the existing structure. The main change would be to enlarge the role of the court in deciding whether or not to approve an arrangement. Safeguards for the interests of beneficiaries incapable of consenting would continue to be required. In addition, the court would be bound to inquire into the changes of circumstances said to justify the proposal. This might be done by means of a remit to a reporter,<sup>5</sup> but in any event it would be likely to make the procedure longer and more expensive. It may also be very difficult to assess, in the case of a private trust, whether a proposed variation was to the advantage of the beneficiaries as a whole when some stood to benefit from it to a greater extent than others. We are not aware of any other jurisdiction having adopted this approach.<sup>6</sup> We do not therefore propose that such an alternative approach be adopted.

### **Possible amendments to existing statutory provisions**

5.6 Section 1(1) and (2) of the 1961 Act (as amended) currently provide as follows:

"(1) In relation to any trust taking effect, whether before or after the commencement of this Act, under any will, settlement or other disposition, the court may if it thinks fit, on the petition of the trustees or any of the beneficiaries, approve on behalf of –

(a) any of the beneficiaries who because of any legal disability or by reason of nonage or other incapacity is incapable of assenting, or

(b) any person (whether ascertained or not) who may become one of the beneficiaries as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, so however that this paragraph shall not include any person who is capable of assenting and would be of that description, or a member of that class, as the case may be, if the said date had fallen or the said event had happened at the date of the presentation of the petition to the court, or

(c) any person unborn,

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<sup>4</sup> Law Reform (Miscellaneous Provisions) (Scotland) Act 1990, s 9; also the Charities and Trustee Investment (Scotland) Act 2005, ss 39-43, discussed in more detail in Part 6.

<sup>5</sup> This is the procedure commonly followed in the case of cy-près schemes for charitable trusts. The reporter, usually a member of the Bar, is commissioned to enquire into the facts of the case and to make a written report to the court.

<sup>6</sup> The nearest equivalent which we have found is the South Australian provision set out at para 5.22 below. Cf section 412 of the American Uniform Trust Code (variation or termination because of circumstances not anticipated by the trustor: see para 3.4) which operates as an alternative avenue to court approval of an extra-judicial agreement under section 411.

any arrangement (by whomsoever proposed, and whether or not there is any other person beneficially interested who is capable of assenting thereto) varying or revoking all or any of the trust provisions or enlarging the powers of the trustees of managing or administering the trust estate:

Provided that the court shall not approve an arrangement under this subsection on behalf of any person unless it is of the opinion that the carrying out thereof would not be prejudicial to that person.

(2) For the purposes of the foregoing subsection a person who is of or over the age of 16 years but has not attained the age of 18 years shall be deemed to be incapable of assenting; but before approving an arrangement under that subsection on behalf of any such person the court shall take such account as it thinks appropriate of his attitude to the arrangement."

5.7 We turn to consider possible amendments to the existing statutory provisions with regard to the following matters:

- the court's approach to highly improbable events, including exoneration of trustees from claims by remote beneficiaries (paragraph 5.8);
- the scope of the definition of "prejudice" or "benefit" to persons upon whose behalf the court is asked to approve an arrangement (paragraph 5.20);
- the need to retain a power to approve on behalf of live, ascertained beneficiaries who lack capacity to consent themselves (paragraph 5.25);
- approval on behalf of untraceable major beneficiaries (paragraph 5.27);
- approval on behalf of major beneficiaries who decline to consent (paragraph 5.29);
- miscellaneous procedural aspects (paragraph 5.38).

### **Highly improbable events**

5.8 As discussed in Part 2, section 1 of the 1961 Act was enacted against a common law background which permitted variation of trust provisions by agreement only where *all* persons with an interest in the trust agreed to do so. In principle this meant that consent of every person with a potential interest was required, however remote and improbable that interest might be. The definition of "beneficiary" in section 1(6) reflects this background: the expression includes "any person having, directly or indirectly, an interest, whether vested or contingent, under the trust." The practical consequence of the common law background, as reflected in this definition, is that there will be cases where the court cannot be satisfied that there is no possibility of prejudice to a person upon whose behalf approval is sought, even where the event which would cause prejudice has a negligible likelihood of occurring. This problem has been exacerbated in recent years by the withdrawal from the market of all the insurance companies who had, in the past, been willing to underwrite the occurrence of remote contingencies by a single-premium insurance policy.<sup>7</sup>

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<sup>7</sup> Alternative solutions, such as retention of a fund for remoter interests (as described in para 4.13), or bank guarantees, may not be available, or will in any event have the disadvantage of continuing administration and consequent expense.

5.9 Arrangements to vary trusts usually consist of an adjustment of the respective rights of the persons most immediately interested in the trust capital and income. The court will, however, be concerned to ensure that the effect of such adjustments is not to cause prejudice to other interests which have not yet emerged and, indeed, may never emerge. Most of the possibilities envisaged tend to fall into two categories, namely (i) the risk of birth of issue, and (ii) the risk of a death or series of deaths causing a remoter interest to emerge.

#### *Risk of birth of issue*

5.10 The risk of birth of issue cannot be actuarially calculated and, as such, has never been insurable. In consequence, this risk has often constituted a block on a possible variation. For example, assume that property is held in an accumulation and maintenance trust for the children of A, with a share of capital vesting in each child at age 40, subject to a destination over to another branch of the family should none of the children attain that age. A has three children, aged 25, 22 and 20. None are yet married. The children wish to bring the trust to an end, subject to making appropriate provision for the contingency that one or more of them might die prior to attaining age 40. This latter contingency may be addressed by retaining a fund equivalent to (or, in practice, a little greater than) the actuarial value of the interests of the persons who would become entitled to shares of the fund should any of A's children fail to attain age 40. However it is not possible to address, by insurance or retention of a fund or otherwise, the possibility that further issue, who would also be entitled to shares of capital, may yet be born to A. The trust cannot therefore be terminated. In this example, if A was a male aged, say, 45, then the risk of birth of further issue might be real. On the other hand if A was aged 70, and the three children were in their thirties, then the likelihood of the birth of further issue of A, though biologically possible, might in reality be negligible.

5.11 There is no presumption that a male attains an age at which he ceases to be a potential parent. The matter was considered in a different context in *Munro's Trustees v Monson*,<sup>8</sup> in which trustees presented a special case to determine whether they were bound, or at least entitled, to pay out trust capital to a beneficiary on the assumption that two males then aged 81 and 76 would not have male issue. The court applied a test of "high improbability" and found that as a matter of fact the risk of birth of male issue was minimal. The trustees were held entitled to denude, subject to the granting of an indemnity by the recipient. Even on these facts, however, Lord Justice-Clerk Grant regarded the matter as "a very narrow one". The case is of limited assistance in the context of judicial variation of trusts. It has not hitherto been the practice of the court in such applications to be satisfied that a personal indemnity by a beneficiary affords sufficient protection (by way of assurance that if the improbable event occurred, the necessary funds would be available to satisfy the emerging claims) to the persons upon whose behalf approval is sought. There are no reported cases in which satisfaction of the test of "high improbability" has been regarded as sufficient to meet the requirements of section 1(1) of the 1961 Act.

5.12 The approach taken by the courts in relation to women has been that, prior to 1936, the same test of "high improbability" was applied in determining whether trustees were entitled to pay out capital to the beneficiaries. In *G's Trustees v G*,<sup>9</sup> however, it was held that there was a presumption against a woman aged 53 or more having a child. This appears to

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<sup>8</sup> 1965 SC 84.

<sup>9</sup> 1936 SC 837.

have been simply a presumption of fact, based upon the medical evidence of the day. This decision is still relied upon in applications under the 1961 Act as indicating that certain theoretical possibilities of birth of issue may be disregarded by the court. We doubt whether such reliance can now be justified. Whatever may have been the situation in 1936, it is no longer the case, as a matter of fact, that all women have passed child-bearing age by 53. Nor does the presumption take account of child birth possibilities created by IVF technology. Indeed, since the amendments to the law which gave rights of succession to adopted children, the presumption has not taken account of the possibility of adoption of a child by a woman aged 53 or over, or by a man of any age.

5.13 We consider that the powers of the courts in relation to the disregarding of the possibility of a future birth require to be clarified and, to a certain degree, extended to permit judicial variations to proceed in circumstances in which the risk of prejudice from such a birth is negligible.

#### *Emergence of remote interest*

5.14 The risk of a series of deaths causing a very remote interest to emerge creates a somewhat different problem. The fact that such a contingency may occur means that the persons who would become entitled in these circumstances have an actual interest in the trust. This interpretation of the statutory provisions has latterly found favour in England. In *Knocker v Youle*,<sup>10</sup> the trust deed, which dated from 1932, directed the trustees to pay income to the truster's daughter A, and on her death to hold the trust fund for such persons as she might appoint; which failing, her share was to be added to a share held for the truster's son on similar terms. There was then an ultimate trust in favour of the truster's four sisters and their issue in equal shares *per stirpes*. At the time of the application to vary the trust provisions, the persons who would become entitled under the ultimate trust provisions were numerous, and some were resident in Australia. The question was whether the court could approve the arrangement on their behalf, as persons falling within section 1(1)(b) of the (English) 1958 Act ("any person (whether ascertained or not) who may become entitled, directly or indirectly, to an interest under the trusts as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, ..."). Warner J held that he could not approve the arrangement on their behalf, because they already had an interest; they were not persons who "may become entitled to an interest". Only they themselves could consent to the variation. He rejected an analysis which had previously found favour in some textbooks, namely that the court could competently give approval on behalf of persons whose interest was subject to a double contingency, and not merely a single contingency.

5.15 A different and more pragmatic approach has been taken by the Court of Session. The facts of *Phillips & Others, Petitioners*<sup>11</sup> were not dissimilar to those of *Knocker v Youle*. The testator provided that on his wife's death the income of the residue of his estate was to be paid to his four children and to the issue of predeceasing children, and that on the death of the last survivor of his children the capital was to be paid in certain proportions to the issue then alive of his children. In the event of all of his children dying without leaving issue, the residue was to be divided among various charities and remote relatives. The question addressed by the court was whether it was necessary to protect the interests of any persons

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<sup>10</sup> [1986] 2 All ER 914.

<sup>11</sup> 1964 SC 141.

falling within the longstop category or to obtain the consent of those of full age and capable of consenting. The court held that it was not necessary. Lord President Clyde stated:<sup>12</sup>

"The number of persons or bodies that fall within that class is very substantial and service has not been effected upon those members of this class who are under twenty-one years of age. Those who are older and the charities mentioned in the testamentary writings have not received intimation of the present proceedings. ... In our view, however, their interest is so remote and so negligible that they do not qualify as beneficiaries within the meaning of section 1(6) of the Act and need not be therefore provided for in the scheme. That subsection must be given a reasonable construction and it can never have been intended to include persons whose interest is so remote as to be negligible. If parties choose to make an arrangement outside the scheme for the protection of this group of persons, they are of course free to do so ..."

The decision in *Phillips* has proved useful in trust variation practice because it has enabled arrangements to be approved without the need to intimate the proceedings to, and obtain the consent of, distant relatives with negligible interests. However, the solution which it provides is not entirely satisfactory. In the first place it is difficult to justify on the wording of the Act. The definition of "beneficiaries" in section 1(6) to which Lord President Clyde made reference uses the same language as the English statute, and it is difficult to see why, in principle, any restriction should be placed on the words "any person having, directly or indirectly, an interest, whether vested or contingent, under the trust". Secondly, if such a restriction is to be placed on the words, it is unclear where the line is to be drawn in determining whether an interest is so remote as to be negligible. In some cases it is reasonably obvious: where, for example, a remote interest can be actuarially valued at a figure of less than £1. In others it is less clear. Thirdly, it should be noted that in *Phillips* the court did not approve the arrangement on behalf of any of the persons with the remote interests: it simply found it unnecessary to approve on behalf of such persons. This, as is evident from the last sentence quoted above, leaves the trustees unprotected in the (very unlikely) eventuality that these interests emerge. Some trustees might reasonably take the view that this exposure is unacceptable, particularly where the trust fund is large and insurance against emergence of the interests cannot be obtained. We consider that a more transparent and straightforward approach to the elimination of remote interests would be desirable.

5.16 The distinction which the statutory definition presently draws between persons with an interest and persons with no interest but who may become entitled to an interest in a trust is capable of producing anomalous results. Warner J drew attention to these in *Knocker v Youle*<sup>13</sup> when he said:

"It is noteworthy that remoteness does not seem to be the test if one thinks in terms of presumptive statutory next of kin. The healthy issue of an elderly widow who is on her deathbed, and who has not made a will, have an expectation of succeeding to her estate; that could hardly be described as remote. Yet they are a category of persons on whose behalf the court could, subject of course to the proviso, approve an arrangement under this Act. On the other hand, people in the position of the cousins in this case have an interest that is extremely remote. None the less, it is an

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<sup>12</sup> *Ibid* at 150-151.

<sup>13</sup> [1986] 2 All ER 914, at 917-8.

interest, and the distinction between an expectation and an interest is one which I do not think I am entitled to blur."

5.17 There is a further reason why the distinction between an expectation and an interest cannot be blurred. An interest in a trust, however remote, is an economic interest which would constitute a "possession" for the purposes of Article 1 of the First Protocol to the European Convention on Human Rights. Article 1 states as follows:

"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law..."

In *James v United Kingdom*,<sup>14</sup> the European Court of Human Rights confirmed that a compulsory transfer of property from one individual to another for no reason other than to confer a private benefit on a private party could not be "in the public interest". A variation of trust provisions which had the consequence of removing or diminishing a beneficiary's interest, however remote, could therefore constitute a breach of Article 1 of the First Protocol. An appropriate analogy might be a National Lottery ticket. The value of a ticket prior to the draw taking place is small – less than the price paid for it. Allowing the court to approve an arrangement which terminates a very remote interest in a trust could be likened to giving the court power to order the destruction of the ticket. The probability of the owner sustaining any prejudice is extremely low, but it is not non-existent. For these reasons we do not consider that it would be compatible with the Convention to enact legislation which would permit the court to approve an arrangement on behalf of any person whose interest was thereby removed or diminished, however negligible the actuarial value of that interest might be.

#### *Proposals for reform*

5.18 We consider that a distinction can be drawn between, on the one hand, the situation where an interest has been created which is unlikely to materialise and, on the other hand, the situation where an interest does not yet exist and is not likely ever to exist. An example of the first situation is the interest of a remote beneficiary, the emergence of whose interest depends upon an improbable series of deaths of prior beneficiaries. An example of the second situation is the hypothetical interest of an unborn child who, in the circumstances of a particular case, will almost certainly never be born. In the second situation we consider that there is no "possession" for the purposes of Article 1 of the First Protocol, provided that the court is satisfied that there will never be a person in existence to own and enjoy it. It would therefore be possible, in our view, to amend the current legislation to permit the court to approve an arrangement varying a trust despite the theoretical possibility of the birth of a beneficiary who would, either by virtue of being born or by satisfying some further contingency, become entitled to an interest which would defeat or diminish other interests in the trust. We see practical advantages in such an amendment. As discussed above,<sup>15</sup> this is the type of situation which cannot presently be dealt with by means of a retained fund, and which cannot be insured against, and which is, as matters stand, capable of constituting an insuperable obstacle to a proposed variation.

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<sup>14</sup> (1986) 8 EHRR 123, para 40.

<sup>15</sup> Paras 5.10 – 5.13.

5.19 At present the court has power under section 1(1)(b) of the 1961 Act to approve an arrangement on behalf of "any person (whether ascertained or not) who may become one of the beneficiaries as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons". Thus, for example, the court may approve a variation on behalf of the unborn members of a class of beneficiaries, such as "the children of X", provided that it is satisfied that there is no prejudice to them. What we are proposing is that the court's power should be extended to permit approval of an arrangement despite the possibility of prejudice to unborn – or indeed unascertained – persons, but only if the court was satisfied that there was no reasonable likelihood of the interest of such persons coming into existence. The court could not, logically, be asked to approve the arrangement *on behalf of* these hypothetical persons. Instead, the statute could provide that the arrangement approved by the court would be effective despite the fact that no consent had been given by them or on their behalf. Certain risks other than birth of issue, such as the possibility of a person marrying, could also fall within the scope of our proposal. The expression "no reasonable likelihood" seems to us to be one which strikes the appropriate balance by way of guidance to the court which is called upon to assess the chance of the interest coming into existence. However, it might be thought to be too vague. If the principle underlying our suggestion is accepted, we would welcome comment (a) as to whether there is an alternative formulation which expresses the test in a clearer fashion (such as "no practical likelihood"; "a negligible risk"; "no realistic prospect", or some other combination of these or similar expressions) or (b) whether any more detailed guidance should be included in the statute with regard to satisfaction of the selected test.

5.20 The proposed change would have consequences for trust variation practice. Evidence would be required to support the petitioners' contention that there was no reasonable likelihood of the interest coming into existence. This might, in appropriate circumstances, consist of medical evidence of infertility. Alternatively, or in addition, it could consist of an affidavit by the putative parent explaining why it could be safely accepted by the court that there was no reasonable likelihood of the birth – or indeed adoption – of issue. We do not envisage that anything by way of a continuing personal guarantee or indemnity would be demanded as a condition of approval. We can see no reason why the change which we propose should prevent applications from being disposed of as they are at present, by a hearing without oral evidence.<sup>16</sup> The beneficial effect of the change would be to permit approval by the court of arrangements which, as matters stand, would be refused as a consequence of the existence of highly improbable risks. We invite comment on the following proposal and question:

5. **(1) Section 1(1) of the Trusts (Scotland) Act 1961 should be amended to permit the court to approve an arrangement notwithstanding the possibility of prejudice to an unborn or unascertained beneficiary, provided that the court is of the opinion that there is no reasonable likelihood that the interest of that person will come into existence.**

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<sup>16</sup> For an English example, see *In re Westminster Bank Ltd's Declaration of Trusts* [1963] 1 WLR 820, in which Wilberforce J approved an arrangement on the footing that a beneficiary would have no further children, taking into account her age (51), the ages of her children (30 and 27) and evidence as to the possibility of the birth of further children, including medical evidence that she was past the age of child-bearing.

**(2) Is there another formulation which is preferable to "no reasonable likelihood" in expressing the statutory test, or, alternatively, is there a need for more detailed guidance as to the criteria for satisfaction of the statutory test?**

5.21 We turn now to consider the situation of beneficiaries with remote interests which are in existence at the time when the application to court is made. Depending upon the terms of the trust, there may be a large number of such beneficiaries. Service of the petition upon them all, and appointment of curators *ad litem* to those under age, could give rise to considerable inconvenience with no real practical utility. It might, for example, involve disclosure of private financial circumstances to distant relatives who would not otherwise be privy to such details and who have no genuine need to be aware of them. At present, as we have noted, this situation is dealt with by means of the court regarding such persons as falling outside the definition of "beneficiary" in section 1(6) of the 1961 Act. While this allows the variation to proceed, it affords no protection to the trustees in the (unlikely) eventuality that the remote contingency materialises. If the fund were sufficiently large this might be of concern to the trustees, particularly as it is unlikely that insurance against this risk could be obtained.<sup>17</sup>

5.22 We have considered two possible solutions. The first is to give the court power to approve an arrangement on behalf of a beneficiary whose interest was so remote as to have a negligible value. The court would not require to be satisfied that the arrangement was not prejudicial; instead it would require to be satisfied that the interest was of so little value that any prejudice should be disregarded. For the reasons which we have set out above, we do not consider that the court could be given power to remove or diminish such interests, regardless of whether they are held by persons of full age or by incapable beneficiaries, as this would be incompatible with the beneficiaries' Convention rights.<sup>18</sup>

5.23 The other solution which we have considered is to give the court power to exonerate and discharge the trustees from future claims by persons with interests which have negligible value at the time of the court hearing. A recent example of the court granting relief of this kind in somewhat different circumstances is afforded by *Neilson's Executors, Petitioners*,<sup>19</sup> regarding exoneration of the executors of a Lloyds Name. This suggestion is consistent with the proposals in our Discussion Paper on *Trustees and Trust Administration*<sup>20</sup> that the court should have power to authorise distribution of the trust estate with relief of the trustees from personal liability. It should be noted that exoneration would not be equivalent to approval of the arrangement on behalf of the remote beneficiary, in that it would not cut off the possibility of a future claim if the contingency emerged. The risk of such a claim would pass to the person benefiting from the variation. If the risk is to remain alive, it seems reasonable to leave it resting with that person rather than with the trustees. It would be necessary to provide expressly in the legislation that the arrangement is effective despite the absence of consent by the remote beneficiary whose interest has been regarded as having

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<sup>17</sup> For example, there might be a beneficiary who, in a very remote and unlikely contingency requiring the predecease of a large number of persons, would become solely entitled to a trust fund worth, say, £5 million. Because the contingency is so unlikely to emerge, the beneficiary's interest may be actuarially valued at less than £1.

<sup>18</sup> The same ought in our view to apply to unborn beneficiaries who would become entitled to an interest on birth and where it cannot be said that there is no reasonable prospect of their birth.

<sup>19</sup> 2002 SLT 1100.

<sup>20</sup> Discussion Paper No 126, para 5.28 and Proposal 22.

negligible value. Again we see no reason why our proposal should prevent applications from being disposed of as they are at present; the only change would be in the substance of the interlocutor pronounced by the court. Instead of finding it unnecessary to approve the arrangement on behalf of remote beneficiaries, there would be an exoneration of the trustees from liability in the event that any such interest emerged. If the court considered the interests to be negligible it would be empowered to dispense with service of the proceedings on the beneficiaries in question.

5.24 Questions may arise as to the level at which the value of an interest becomes sufficiently small to be described as "negligible" and hence falls to be disregarded without any compensating provision for the beneficiary in question. One possibility would be to include a statutory definition of a negligible interest, for example as one with an actuarial value of less than £1, or £10, or other specified sum greater or smaller than these. The sums involved are sufficiently small that they would not be susceptible to being rendered inappropriate by inflation. However, we are provisionally inclined to the view that the expression should not be rigidly defined and that, as at present, it should be left to the court to determine what is or is not, in a particular case, properly to be regarded as a negligible value.

5.25 We invite comment on the following questions:

6. (1) **Should the court be empowered to grant an order exonerating the trustees from liability to all beneficiaries, whether or not of full age and capacity, whose interests at the time of the application are so remote as to be of negligible value?**
- (2) **Is there a need for a statutory definition of an interest of negligible value?**

#### **Definition of "prejudice"**

5.26 There is presently a difference in wording between the English and the Scottish legislation in relation to the matter upon which the court is required to be satisfied. The proviso to section 1(1) of the (English) Variation of Trusts Act 1958 reads as follows:

"Provided that ... the court shall not approve an arrangement on behalf of any person unless the carrying out thereof *would be for the benefit of* that person."

The proviso to section 1(1) of the Trusts (Scotland) Act 1961 is as follows:

"Provided that the court shall not approve an arrangement under this subsection on behalf of any person unless it is of the opinion that the carrying out thereof *would not be prejudicial to* that person."

(Emphasis supplied)

5.27 Most jurisdictions which have enacted trust variation legislation have followed the English wording. The requirement in New Zealand and in Western Australia, however, is

that the arrangement is not to the person's "detriment".<sup>21</sup> In Tasmania the matter is dealt with in greater detail. The court must be satisfied that the exercise of its powers would be in the interest of each person on behalf of whom the court is asked to approve the arrangement, and in so determining the court must have regard to:

- any financial benefit to that person;
- the absence of any financial disadvantage to that person;
- any non-financial benefit to that person;
- the welfare of the family of that person;
- any other circumstances that are advanced for or against the proposed arrangement.<sup>22</sup>

5.28 In one respect the Scottish provision affords greater flexibility than the English version. There is no need in Scotland to demonstrate positive benefit to persons upon whose behalf the court is asked to approve the arrangement; it is sufficient that the scheme does not leave them worse off. This can be useful where, for example, the arrangement provides for a "trade-off" between two interests, leaving neither of them better or worse off as a result. On the other hand, the difference in expressions has led to a difference in interpretation in respect of which the English courts have taken a more expansive view. It is clear from the English case law that, in deciding whether an arrangement is for the benefit of a person, the court is entitled to consider more than purely material benefit. For example, it has been held to be to the benefit of a child that vesting of capital be postponed beyond the age of 21 when vesting would otherwise have taken place, where the child had shown herself to be "alarmingly immature and irresponsible as regards money".<sup>23</sup> This decision could, of course, be regarded as considering purely material benefit, albeit looking to the longer term. The same cannot be said for *Re C L*,<sup>24</sup> in which the court approved an arrangement on behalf of an incapable adult, under which a small life interest was brought to an end in order to effect a substantial estate duty saving. Cross J took the view that although there was a minor financial detriment to the beneficiary, it was nevertheless for her benefit to do something which the court was satisfied she would have done had she been able. A more extreme view of "benefit" was taken in *Re Remnant's Settlement Trusts*,<sup>25</sup> in which the court approved a variation deleting a forfeiture clause which excluded from benefit persons who were, or were married to, Roman Catholics. Pennycuik J held that it was for the benefit of all members of the family (including those whose entitlements would be

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<sup>21</sup> Trustee Act 1956, s 64A(1) (New Zealand); Trustees Act 1962, s 90(2) (Western Australia). A more restrictive model is provided by South Australia, which considers the trust as a whole and requires the court to be satisfied:

- that the application to the court is not substantially motivated by a desire to avoid, or reduce the incidence of tax;
- that the proposed exercise of powers would be in the interests of beneficiaries of the trust and would not result in one class of beneficiaries being unfairly advantaged to the prejudice of some other class;
- that the proposed exercise of powers would not disturb the trusts beyond what is necessary to give effect to the reasons justifying the exercise of the powers; and
- that the proposed exercise of powers accords as far as reasonably practicable with the spirit of the trust (Trustee Act 1936, s 59C(3)).

<sup>22</sup> Variation of Trusts Act 1994, s 14.

<sup>23</sup> *In re T's Settlement Trusts* [1964] Ch 158.

<sup>24</sup> [1969] 1 Ch 587.

<sup>25</sup> [1970] Ch 560.

reduced by deletion of the forfeiture clause) that this source of family friction should be removed. Conversely, the English courts have refused arrangements which were clearly to a beneficiary's financial advantage on the ground that this was outweighed by educational and social disadvantage.<sup>26</sup>

5.29 There is very little Scottish authority on the interpretation of the parallel provision in section 1(1) of the 1961 Act. Such dicta as there are in the reported cases tend to indicate that the court will look only to the presence or absence of financial prejudice.<sup>27</sup> There is none which suggests the contrary. The usual practice is to address only financial prejudice. It seems likely that the Scottish court would take a sufficiently broad view of "prejudice" to allow postponement of vesting to protect an irresponsible beneficiary,<sup>28</sup> on the basis that this would not be to his or her financial prejudice in the longer term. It is less likely that the court would go further and sanction a scheme which was clearly to a beneficiary's financial disadvantage, on the ground that there was a non-financial benefit such as, say, increased opportunities for long-term tax and estate planning for the beneficiary and his unborn issue together as a family. It might be argued that the word "prejudice" lends itself less to a broad interpretation than the word "benefit". This can be contrasted with the position of an incapable adult, whose guardian may be authorised to make gifts, for example in order to avoid tax liabilities, out of his estate.<sup>29</sup>

5.30 We think that the provision quoted above from the Tasmanian Act affords a useful illustration of how legislation could make clear that the court may have regard to considerations other than pure financial prejudice. We invite comment on the following question:

7. **Should the legislation be amended to make clear that in assessing the question of prejudice, the court may have regard to factors other than financial advantage or disadvantage to the beneficiary in question?**

#### **Retention of power to approve on behalf of live ascertained beneficiaries**

5.31 If our proposals in Part 4 of this paper were to be enacted, it would cease to be a statutory requirement to seek court approval of an arrangement on behalf of any live, ascertained beneficiary, regardless of age. The next question which we address is whether it should remain *competent* to seek such approval or, alternatively, whether the court's jurisdiction under the 1961 Act should be restricted to approval only on behalf of unborn and unascertained beneficiaries. Our provisional view is that the jurisdiction should not be thus restricted, so that court approval on behalf of beneficiaries who lack the capacity to consent themselves would remain as an alternative to extra-judicial variation. We can envisage a variety of situations in which parties would for practical reasons require, or at least prefer, to

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<sup>26</sup> Eg having to reside in Jersey instead of being "brought up in this our England, which is still 'the envy of less happier lands'" (*Re Weston's Settlements* [1969] 1 Ch 223, 245, Lord Denning MR).

<sup>27</sup> See eg *Young's Trs, Petitioners* 1962 SC 293, Lord President Clyde at 301; *Pollok-Morris & Others, Petitioners* 1969 SLT (Notes) 60, in which the court refused an arrangement which would have extended the class of discretionary beneficiaries to include adopted children.

<sup>28</sup> In one recent (unreported) application the court was willing to postpone vesting in a beneficiary aged 17 with learning difficulties. However the beneficiary was sufficiently *capax* to indicate his consent to the scheme and so this is not a definite indication that the court would of itself have been willing to disregard the immediate financial detriment caused by postponement.

<sup>29</sup> Adults with Incapacity (Scotland) Act 2000, s 66.

seek court approval rather than to carry out the scheme without court involvement. These might include the following:

- where there is disagreement between a child's legal representatives as to whether to grant consent;
- where a parent unreasonably refuses consent;
- where a parent reasonably refuses consent on the ground that the decision whether or not to consent is narrow, and he or she would prefer not to be accountable for it after the child has attained age 16;
- where a parent is unable (or prefers not) to grant consent because of a conflict of interest between himself or herself on the one hand and the child on the other;
- where the child's parents are dead or untraceable and no guardian to the child has been appointed.

The court would no doubt wish to be informed why its consent was being sought on behalf of a live, ascertained beneficiary, but this could be dealt with by appropriate averments in the petition and in oral submissions. For these reasons we do not propose any reduction in the categories of person upon whose behalf approval of an arrangement may be sought. Nor do we propose to change the present procedure whereby a curator *ad litem* is appointed to represent the interests of a beneficiary who lacks capacity to give instructions.

5.32 Another situation in which court involvement could usefully continue is where an application requires to be made to court (for example, because there are unborn potential beneficiaries) and one of the existing beneficiaries is aged 16 or 17. We have discussed above<sup>30</sup> the difficulties which could arise if such a beneficiary's right to seek to have the arrangement set aside after he or she attained age 18 were not excluded. If, however, it is considered that this right should not be excluded, the court could be given a power, equivalent to that contained in section 4 of the Age of Legal Capacity (Scotland) Act 1991, to ratify the arrangement so far as that beneficiary is concerned, if asked to do so either by the beneficiary or by one or more of the applicants, or by the trustees. By this means, and at little additional expense if the application is coming before the court in any event, the risk of future challenge could be removed. We invite comment on the following proposal:

- 8. It should remain competent to apply to the court for approval of an arrangement on behalf of a beneficiary upon whose behalf consent could, in terms of our other proposals, also be given by a legal representative or other person.**

#### **Approval on behalf of untraceable beneficiaries**

5.33 The court has no power under section 1 of the 1961 Act to approve an arrangement on behalf of untraceable beneficiaries. This will not always constitute an insuperable barrier to variation of the trust provisions. It may, for example, be possible to persuade the court that the arrangement protects the interests of all members of a class of beneficiaries, so that

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<sup>30</sup> Para 4.21.

it can be approved on behalf of minor, unborn or unascertained members of that class even if service has not been effected upon all of them. Alternatively, it may be possible to establish that an interest is of negligible value so that the court may dispense with service and find it unnecessary to approve the arrangement on behalf of the beneficiary in question. This appears to be what happened in *Morris, Petitioner*,<sup>31</sup> in which the court found it unnecessary that the consent of an untraceable beneficiary with a remote interest be exhibited to the court. For reasons discussed elsewhere in this paper,<sup>32</sup> this is not entirely satisfactory from the standpoint of the trustees as they are left unprotected should the claim later emerge.

5.34 The real difficulty is where there is an untraceable beneficiary whose identity is ascertainable and who is of full age, so that the court has no power to approve the arrangement on his or her behalf and who has a non-negligible interest which would be affected by the variation. In such circumstances it would, as the law stands, be pointless for the other beneficiaries to proceed with an application as it would be futile. We consider that it would be helpful to amend the existing law in order to permit the court to approve an arrangement on behalf of such a person, subject to the court being satisfied that the scheme was not prejudicial to that person's interests. It would be for the petitioner to satisfy the court that there would be no such prejudice, using the same methods as are currently used in relation to the interests of persons who are incapable of consenting on their own behalf. The effect of such approval would be to remove the possibility of future challenge if the beneficiary re-appeared and claimed to have been prejudiced by the arrangement because of, for example, the emergence of an unlikely contingency. Power to approve on behalf of an untraceable beneficiary exists or has been recommended for introduction in various other jurisdictions.<sup>33</sup> We would propose to follow the Irish and British Columbian proposals by providing that the court would require to be satisfied that reasonable steps had been taken to trace the whereabouts of the beneficiary in question. We invite comment on the following proposal:

- 9. Section 1 of the 1961 Act should be amended to permit the court to approve an arrangement on behalf of a person whose continued existence or whereabouts cannot, despite reasonable steps having been taken, be established, provided that the court is satisfied that the proposed arrangement would not be prejudicial to that person's interests.**

It does not seem to us that there is a need for statutory specification of the steps which would require to be taken to trace the beneficiary, but we would welcome any views on this.

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<sup>31</sup> 1985 SLT 252. The report is brief, but the reference in it to *Phillips* 1964 SC 141 suggests that not only was the beneficiary untraceable, but also that her interest was of negligible value.

<sup>32</sup> See para 5.15.

<sup>33</sup> Provision already exists in, for example, Manitoba ("any person who is missing and whose whereabouts are unknown to the trustee"); Alberta ("any person who is a missing person [as defined in another statute]"); and Tasmania ("a person whose whereabouts are unknown"); and would fall within the terms of the US Uniform Trust Code, s 411(e). It has been recommended for introduction in Ireland (Law Reform Commission *Report on the Variation of Trusts*, LRC Report No 63, 2000) ("any person whose identity, existence or whereabouts cannot be established by taking reasonable measures"); and in British Columbia (British Columbia Law Institute *Report on the Variation and Termination of Trusts*, BCLI Report No 25, 2003) ("any person... whose continued existence or whereabouts cannot be established despite reasonable measures having been taken to discover such information").

## Approval on behalf of major beneficiaries who decline to consent

5.35 Another situation in which a variation may be prevented from proceeding is where there is a beneficiary of full age whose consent to the arrangement is required but who withholds consent, despite the fact that he or she would sustain no prejudice as a result of the scheme. The question whether the court should have power in such circumstances to approve the arrangement on behalf of the non-consenting beneficiary was raised in the recent British Columbia consultation process. This was against the background of a case<sup>34</sup> in which the court had held that it had power to approve a variation of a pension trust scheme on behalf of a small number of scheme members who had refused to consent. The British Columbia Law Institute invited comment on whether the courts should have power to approve on behalf of non-consenting adults. The majority of consultees favoured the grant of such power, although some preferred to restrict the power to schemes involving pension or commercial trusts only. The Institute concluded that the courts should have power to deal with an intransigent beneficiary, but only where (a) the variation is not detrimental to the non-consenting beneficiary; (b) consent, or approval by the court, is given on behalf of "a substantial majority" of beneficiaries; and (c) it would be detrimental to the administration of the trust and the interests of other beneficiaries not to approve the arrangement. The US Uniform Trust Code<sup>35</sup> also provides for approval to be given despite the absence of consent of a beneficiary (whether because the beneficiary refuses consent, or is untraceable, or otherwise). The court must be satisfied (1) that if all the beneficiaries had consented, the trust could have been modified, and (2) that the interests of a beneficiary who does not consent will be "adequately protected".

5.36 In Scotland, the theoretical basis underpinning court approval of a variation is the rule in *Miller's Trustees*. In an application under the 1961 Act the court effectively supplies approval on behalf of interests incapable of consenting themselves. It would be inconsistent with this underlying rationale of consensus (and deemed consensus) to permit the court to supply approval on behalf of non-consenting adult beneficiaries even where they would sustain no prejudice. Without a consistent theoretical foundation, it is more difficult for the courts to reach a view as to how to resolve any dispute which arises in relation to the operation of the statute. We are not aware that refusal of consent by adult beneficiaries is a common problem in practice, although we welcome views as to whether or not it has caused any difficulties.

5.37 On the other hand, it might be argued that it is unfair to consenting beneficiaries, and to those upon whose behalf the court is called upon to approve an arrangement, that the scheme can be vetoed by persons who *ex hypothesi* are no worse off as a consequence of it. The British Columbia experience indicates that it is not impossible to permit the court to approve an arrangement on behalf of a non-consenting adult who is not prejudiced thereby, albeit at the expense of some theoretical coherence. One possible approach would be to make use of the "material purpose" doctrine in this situation only: for example, to provide for the court to approve the scheme on behalf of such a person, but only if satisfied that the variation is not inconsistent with the wishes of the truster. Alternatively, the court could be

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<sup>34</sup> *Bentall Corp v Canada Trust Co* (1996) 26 BCLR (3d) 181. The question whether the court had power under the British Columbia legislation to give such approval has been the subject of debate. The decision seems to conflict with the analysis of Warner J in *Knocker v Youle* [1986] 2 All ER 914 (discussed at paras 5.15 - 5.16 above).

<sup>35</sup> S 411(e).

given a wider power to approve an arrangement on behalf of a non-consenting adult who is not prejudiced thereby, if in all the circumstances the court considers it to be in the interests of the beneficiaries of the trust (including the non-consenting beneficiary) to do so. We invite responses to following questions:

- 10. (1) Should it remain necessary to obtain the consent of all ascertained and traceable beneficiaries of full age and capacity, provided that they have a non-negligible interest in the trust?**
- (2) Alternatively, should the court be empowered to approve an arrangement on behalf of a non-consenting beneficiary of full age and capacity, provided that the court is satisfied that that beneficiary is not prejudiced by the arrangement?**
- (3) If alternative (2) is preferred, should there be an additional requirement to be fulfilled that the proposed arrangement is not inconsistent with the wishes of the truster, or that it is in the interests of the beneficiaries as a whole, or some other requirement?**

### **Miscellaneous procedural aspects**

#### *Right to make the application*

5.38 In terms of section 1(1) of the 1961 Act, an application may be made by "the trustees or any of the beneficiaries". There is no equivalent restriction in the Variation of Trusts Act 1958. The current practice in Scotland, when there is no beneficiary of full age with an interest to make the application, is for the trustees to present the petition. This might not always be satisfactory. In *Re Druce's Settlement Trusts*,<sup>36</sup> Russell J expressed concern that where trustees make the application there is no-one to be the watchdog for unborn and unascertained interests. He observed:<sup>37</sup>

"...In general, the trustees should not be the applicants in applications to vary beneficial trusts, unless they are satisfied that the proposals are beneficial to the persons interested and have a good prospect of being approved by the court, and further, that if they do not make the application no one will."

Similar considerations tend to be taken into account in Scotland.

5.39 In the English case of *In re T's Settlement Trusts*,<sup>38</sup> the application was made by the mother of a minor beneficiary. This could be done in Scotland by virtue of a mother being her child's legal representative.<sup>39</sup> The draft Bill produced by the Irish Law Reform Commission<sup>40</sup> provides for an application to be made by the trustees, any beneficiary, or "such other person as the court sees fit". We invite responses to the following question:

- 11. Is there a need to extend the right to make an application in Scotland to persons other than the trustees and the beneficiaries?**

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<sup>36</sup> [1962] 1 WLR 363.

<sup>37</sup> At 371.

<sup>38</sup> [1964] Ch 158.

<sup>39</sup> Children (Scotland) Act 1995, s 1(1)(d), s 15(5).

<sup>40</sup> Law Reform Commission *Report on the Variation of Trusts*, LRC Report No 63, 2000.

### *Representation of parties*

5.40 The ground rules for representation of parties were laid down at an early stage in *Robertson & Others, Petitioners*<sup>41</sup> and *Findlays, Petitioners*.<sup>42</sup> According to the procedure prescribed in these cases, where there are no disputed facts, and provided there are separate counsel to represent the conflicting interests, the same solicitors may instruct them all. We do not propose any statutory change to this procedure.<sup>43</sup> It has sometimes been questioned whether the expense of separate representation by counsel is justifiable. In most cases counsel instructed by consenting parties play a very minor role in the proceedings. However it remains the case that amendments are frequently made to the arrangement immediately prior to or during the hearing, and it seems necessary for each separate interest<sup>44</sup> to have a representative present to assess the consequences of an amendment for that interest, especially where separate solicitors have not been instructed. If there were no-one present to consider the matter from the point of view of each conflicting interest, the matter might have to be adjourned to another day, with the resultant increase in expense and delay.

### *Consent of the truster*

5.41 Consistently with our proposal that a doctrine of material interest should not be introduced,<sup>45</sup> we suggest that it be made clear that the consent of the truster (in that capacity) to the proposed arrangement is not required. We do not propose altering the current practice whereby the truster is entitled to receive notice of the petition and to be heard if he wishes on the question which is being addressed by the court, namely that of prejudice to beneficiaries upon whose behalf the court's approval is sought. However, the truster's consent should not, in our view, be a pre-requisite of court approval.

### *Public or private hearings*

5.42 Hearings are conducted on the summary roll, in public. Concerns have sometimes been expressed that private family financial arrangements may be discussed in a public court. These concerns are most likely to arise in relation to families in whom the media take an interest. We do not intend to propose any change to present practice. Hearings in private would be difficult to justify, especially against the background of Article 6 of the European Convention on Human Rights which requires public hearings. In practice, financial details are provided to the court in documentary form and the figures are seldom discussed expressly in the course of the hearing. It does not appear to us that there is any undue exposure of details of family finances.

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<sup>41</sup> 1962 SC 196, Lord President Clyde at 203-4.

<sup>42</sup> 1962 SC 210, Lord President Clyde at 214.

<sup>43</sup> We understand, however, that in practice it is becoming more common for separate solicitors to be instructed, in the light of professional regulations regarding conflicts of interest, and in particular to advise on the taxation consequences of the proposed scheme for different members of the class of beneficiaries.

<sup>44</sup> An interest may of course be shared by several persons, in which case there is a single representation of all of those sharing the interest.

<sup>45</sup> See para 5.3 above.

### *Arrangement effecting a re-settlement*

5.43 Some difficulty has arisen in England as to whether the terms of the Variation of Trusts Act 1958 were sufficiently wide to encompass a re-settlement.<sup>46</sup> It was held that an arrangement which effected a revocation and re-settlement could be described as a variation, provided that the "substratum" of the original trust remained. Only then could it be said that the arrangement was merely varying the trust, though the means employed were wholly different and the form was completely changed. Such concerns have not been shared by the Scottish courts. A variation in Scotland may or may not amount to a re-settlement.<sup>47</sup> It has been common in the past (though less so in current practice) for an arrangement to include a provision stating that "...from the operative date [usually the date of the court's interlocutor] the whole trust purposes and provisions of the trust deed shall come to an end and be determined". Clearly this may amount to re-settlement, as was acknowledged by the court in *Aikman, Petitioner*.<sup>48</sup> One practical consequence is that fresh accumulation periods may be included in the new trust provisions. In the absence of any indication to date that there is doubt as to the competency of the court to approve an arrangement which effectively constitutes a re-settlement, it may be unnecessary to propose any amendment to the current statutory provisions. On the other hand, if section 1 is to be substantially re-written, an express reference to re-settlement could be included, in order to put the matter beyond doubt. We invite responses to the following question:

- 12. Is there a need to specify in the legislation that an arrangement may take the form of a re-settlement of the whole or part of the trust estate?**

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<sup>46</sup> See *In re Ball's Settlement Trusts* [1968] 1 WLR 899; *In re Holt's Settlement* [1969] Ch 100.

<sup>47</sup> The tax consequences will differ depending upon whether or not an arrangement amounts to a re-settlement. A re-settlement is likely to constitute an occasion of charge to capital gains tax, whereas a variation without a re-settlement may not, depending upon the effect of the arrangement.

<sup>48</sup> 1968 SLT 137, Lord President Clyde at 141: "...the arrangement fundamentally and almost completely supersedes the original trust provisions and in effect makes a new settlement".

# Part 6 Reorganisation of non-charitable public trusts

## Introduction

6.1 In this Part of the Discussion Paper we consider the reorganisation of public trusts. A public trust is a trust which is created for the benefit of the public at large, or of a section of the public, rather than for the benefit of a class of individuals specified by the truster. In contrast to a private trust, its terms can be enforced by a member of the public with an existing or contingent interest,<sup>1</sup> or by the Lord Advocate in the public interest. In contrast to the position under English law, it is possible in Scotland for a trust to be a public trust without being a charitable trust.<sup>2</sup> The exact scope of "charity" in Scots law, for non-fiscal purposes, has in the past been unclear. In practice, since one of the most important features of charitable status is obtaining the benefit of tax reliefs, the technical English meaning of "charity" which applies in Scotland for tax purposes<sup>3</sup> tends to overshadow any different meaning which the word may have had in Scots law. Most, but not all, public trusts are charitable trusts. Examples of non-charitable public trusts are trusts for political purposes, and trusts for social purposes which fall short of being charitable because they are for general benefit rather than for the benefit of persons in need of financial support.<sup>4</sup> Although such trusts lack the charitable ingredient, they share with charities a need for public accountability.

6.2 The Charities and Trustee Investment (Scotland) Act 2005 (to which we will refer as "the Charities Act") introduces a comprehensive new regime for the definition and regulation of charities in Scotland. A body (including a charitable trust) will not be a "charity" unless and until it has been registered by the Office of the Scottish Charity Regulator ("OSCR") in the Scottish Charity Register. In order to be registered, a body must meet "the charity test", which it will do only if (a) its purposes consist only of one or more of the charitable purposes listed in section 7(2) and (b) it provides or intends to provide "public benefit" in Scotland or elsewhere.<sup>5</sup> There is no longer a presumption that a body whose objects are the relief of

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<sup>1</sup> *Bow v Patrons of Cowan's Hospital* (1825) 4 S 276; *Miller v Black's Trs* (1837) 2 S & McL 866, Lord Brougham at 893; *Ross v Governors of Heriot's Hospital* (1843) 5 D 589, Lord Cunninghame at 609, *Andrews v Ewart's Trs* (1886) 13 R (HL) 69, Lord Watson at 73. But see *Addison v White* (1870) 8 M 909; *Mackie v Presbytery of Edinburgh* (1896) 23 R 668.

<sup>2</sup> Wilson and Duncan, *Trusts, Trustees and Executors* (2<sup>nd</sup> edn, 1995), para 14-02.

<sup>3</sup> *IRC v Pemsel* [1891] AC 531; *Inland Revenue v Glasgow Police Athletic Association* 1952 SC 102; 1953 SC (HL) 13.

<sup>4</sup> "To increase the virtue and happiness of persons who are already virtuous and happy is essentially benevolent, but is not necessarily charitable": *Caldwell's Trs v Caldwell* 1920 SC 700, Lord Skerrington at 702.

<sup>5</sup> Charities and Trustee Investment (Scotland) Act 2005, s 5(1), s 7(1). The charitable purposes are:

- (a) the prevention or relief of poverty,
- (b) the advancement of education,
- (c) the advancement of religion,
- (d) the advancement of health,
- (e) the saving of lives,
- (f) the advancement of citizenship or community development,
- (g) the advancement of the arts, heritage, culture or science,
- (h) the advancement of public participation in sport,

poverty or advancement of religion or education is a charity. A duty is imposed on OSCR to issue guidance as to how it determines whether a body meets the charity test.<sup>6</sup> It seems clear that there will continue to be public trusts which are not charitable according to the new definition. The ranks of non-charitable public trusts may well be increased by trusts which are unable to satisfy the new public benefit requirement.

6.3 Chapter 5 of the Charities Act contains provisions for reorganisation of charities, discussed in more detail below.<sup>7</sup> As regards non-charitable public trusts, following consultation, the Scottish Executive stated:<sup>8</sup>

"Now that it has been decided that all reorganisations of charities should be considered by OSCR, with an appeal to the Scottish Charities Appeal Panel, rather than to the sheriff court, it is considered that it is no longer appropriate for OSCR to oversee the reorganisation of non-charitable trusts. OSCR is the charity regulator, with no real remit for non-charitable bodies, and it is not considered appropriate that the Scottish Charities Appeal Panel should act as an appellate body for non-charitable public trusts. It has therefore been decided to exclude non-charitable public trusts from the reorganisation provisions of the Bill, and leave the current regime of the 1990 Act in place for all such trusts at present. The Scottish Executive will ask the Scottish Law Commission to take the 1990 Act regime into account in its ongoing programme of work to review trust law."

We have no accurate information as to how many non-charitable public trusts are in existence. It is therefore difficult to assess how many trusts remain subject to the 1990 Act following the removal of charitable trusts to the new regime under the Charities Act. We understand, however, that only a small proportion of the applications for reorganisation of public trusts which have been made since OSCR was established have concerned non-charitable trusts.

### **Development of the present law**

6.4 Before 1990, the only means by which the terms of public trusts (including charitable trusts) could be altered was by means of an application to the *nobile officium* of the Court of Session for approval of a *cy-près* scheme. This was, and remains, competent (i) where there is gift for a public purpose but the truster has not specified the means by which the purpose is to be effected; (ii) where there is initial failure of the trust purposes but a general charitable intention can be discerned in the terms of the settlement; and (iii) where there is a bequest to a particular charitable object which fails after the bequest has taken effect.<sup>9</sup> In

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(i) the provision of recreational facilities, or the organisation of recreational activities, with the object of improving the conditions of life for the persons for whom the facilities or activities are primarily intended,  
(j) the advancement of human rights, conflict resolution or reconciliation,  
(k) the promotion of religious or racial harmony,  
(l) the promotion of equality and diversity,  
(m) the advancement of environmental protection or improvement,  
(n) the relief of those in need by reason of age, ill-health, disability, financial hardship or other disadvantage,  
(o) the advancement of animal welfare,  
(p) any other purpose that may reasonably be regarded as analogous to any of the preceding purposes."

<sup>6</sup> *Ibid*, s 9.

<sup>7</sup> See para 6.7.

<sup>8</sup> Policy Memorandum relative to the Charities and Trustee Investment (Scotland) Bill, para 72.

<sup>9</sup> For a full discussion, see Wilson and Duncan, *op cit*, ch 15.

exercising its jurisdiction, the court must select the scheme most "nearly in accordance with the original purpose for which the fund was established".<sup>10</sup>

6.5 The circumstances in which public trusts could be reorganised were widened significantly by sections 9 to 11 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990.<sup>11</sup> Three new possibilities were introduced, as follows:

(i) The court<sup>12</sup> may approve a scheme for the variation or reorganisation of the trust purposes if satisfied:

- that they have been fulfilled or can no longer be given effect to;
- that they provide a use for only part of the trust estate;
- that they were expressed by reference to an area or a class of persons which has ceased to be suitable or appropriate, or as regards which administration of the trust estate has ceased to be practicable; or
- that since the trust was constituted, they have become adequately provided for by other means, or have ceased to be such as would qualify for charitable status, or have ceased in any other way to provide a suitable and effective method of using the trust property.<sup>13</sup>

Regard must be had to the spirit of the trust deed or other document constituting the trust. The proposed scheme must enable the resources of the trust to be applied to better effect, consistently with the spirit of the trust deed<sup>14</sup>, and with regard being had to changes in social and economic conditions since the time when the trust was constituted.<sup>15</sup> Applications must be intimated to the Lord Advocate who may enter proceedings in the public interest.<sup>16</sup>

(ii) In the case of a "small" trust, ie a trust with an annual income not exceeding £5,000, the trustees may in any of the circumstances set out in subparagraph (i) above pass a resolution that the trust purposes shall be modified, or that the whole of the assets should be passed to another public trust, or that the trust should be amalgamated with one or more other public trusts.<sup>17</sup> The resolution must be advertised locally. Details of the scheme and of its advertisement, and of any objections received, must be provided by the trustees to the Lord Advocate,<sup>18</sup> who may direct the trustees not to proceed with the scheme.<sup>19</sup>

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<sup>10</sup> *Kirk Session of Prestonpans v School Board of Prestonpans* (1891) 19 R 193, 199 (Lord President Robertson).

<sup>11</sup> These sections are reproduced in Appendix A.

<sup>12</sup> In the Court of Session: 1990 Act, s 9(4). A power contained in s 9(5) to extend jurisdiction to the sheriff court has not been exercised.

<sup>13</sup> 1990 Act, s 9(1).

<sup>14</sup> Described in *Inverclyde Council v Dunlop* 2005 SLT 967 as an "elusive concept".

<sup>15</sup> 1990 Act, s 9(2).

<sup>16</sup> *Ibid*, s 9(6). The supervisory powers conferred upon the Lord Advocate in relation to charities by the 1990 Act have in practice been exercised on his behalf by the Scottish Charities Office and latterly by OSCR in a non-statutory capacity.

<sup>17</sup> 1990 Act, s 10(1)–(3).

<sup>18</sup> Public Trusts (Reorganisation) (Scotland) (No 2) Regulations 1993 (SI 1993/2254).

<sup>19</sup> 1990 Act, s 10(14).

(iii) In the case of a trust with an annual income not exceeding £1,000 whose constituting deed prohibits the expenditure of trust capital, the trustees may decide to expend capital if (i) the income is too small to enable the trust purposes to be achieved, and (ii) either there is no prospect of achieving an amalgamation under section 10 or expenditure of capital is more likely to achieve the trust purposes.<sup>20</sup> Their decision must be advertised locally and intimated to the Lord Advocate who may apply to the court for an order prohibiting such expenditure.

The *cy-près* jurisdiction of the Court of Session was expressly preserved as an alternative to application under the 1990 Act. In certain circumstances, notably initial failure of trust purposes, application for approval of a *cy-près* scheme remained the only competent means of proceeding.

6.6 Special provisions in the Education (Scotland) Act 1980 apply to "educational endowments", ie property dedicated to charitable purposes which is applied to educational purposes including payments towards the cost of professional training and apprenticeship fees, the provision of maintenance, clothing and other benefits, and the payment of grants for travel.<sup>21</sup> Local authorities are given power to prepare schemes which, inter alia, alter the purposes for which educational endowments are held.<sup>22</sup> Similarly, the governing body of an educational endowment not managed by a local authority may apply to the court for approval of a scheme for the future government and management of the endowment.<sup>23</sup> A scheme may, inter alia, provide for any of the following: altering the purposes to which such endowments are applied and the conditions and provisions regarding such application; grouping, amalgamating, combining or dividing such endowments; altering the constitution of the governing body or uniting two or more existing governing bodies; or altering powers of investment of the funds. In deciding whether or not to approve the scheme, the court must have regard:

- (a) to the spirit of the intention of the founders as embodied either in the original deed constituting the endowment where it is still the governing instrument, or in any previously-approved scheme;
- (b) to the interest of the locality to which the endowment belongs;
- (c) to the possibility of effecting economy in administration by the grouping, amalgamation or combination of any two or more endowments; and
- (d) to the need for continuing the provision from endowments of competitive bursaries at universities, colleges of education or other educational institutions of a similar character.

6.7 The position with regard to reorganisation of charities, including those which take the form of a charitable trust, has now been significantly amended by the Charities and Trustee

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<sup>20</sup> 1990 Act, s 11; 1993 Regulations, reg 7.

<sup>21</sup> Education (Scotland) Act 1980, s 122(1). Educational endowments are excluded from the scope of the 1990 Act by s 15(9) of the latter Act.

<sup>22</sup> *Ibid*, s 105(1).

<sup>23</sup> *Ibid*, s 105(4A), inserted by the Education (Scotland) Act 1981, Sch 6, para 4(g). Section 105 is reproduced at Appendix A.

Investment (Scotland) Act 2005.<sup>24</sup> Section 39 of the Act provides a mechanism whereby a "reorganisation scheme" varying the constitution of a charity, transferring its property to another charity, or amalgamating the charity with another charity, may be approved by OSCR without the need for an application to the court. An application must be made in the first instance by the charity to OSCR which must be satisfied that one of the "reorganisation conditions" is satisfied in relation to the charity. The conditions, set out in section 42(2), largely repeat in more concise form the conditions for court approval of a reorganisation under section 9 of the 1990 Act. One new condition is added, namely that a provision of the charity's constitution, other than a provision setting out its purposes, can no longer be given effect or is otherwise no longer desirable. Also retained from the 1990 Act is the requirement that the proposed reorganisation scheme must enable the resources of the charity to be applied to better effect for charitable purposes, consistently with the spirit of its constitution, and with regard being had to changes in social and economic conditions since the time when it was constituted. OSCR has power under section 39 to approve the reorganisation scheme. Alternatively, OSCR may, of its own accord or if asked to do so by the charity trustees, apply under section 40 to the Court of Session for approval of the scheme by the court. It is no longer competent for the charity itself to apply to the Court of Session for approval under section 9 of the 1990 Act.<sup>25</sup>

6.8 The Act thus provides a comprehensive scheme for variation or reorganisation of charitable trusts. No special provision is made, as it was in 1990, for small trusts or for trusts with a small income, because the role of OSCR renders such special provision unnecessary. The Act also applies to schemes for reorganisation of educational endowments whose governing body is a charity, and the provisions of the Education Act 1980 cease to apply to such endowments.<sup>26</sup> The provisions of the Act do not however apply to any charity constituted under a Royal charter or warrant or under any enactment.<sup>27</sup> The Court of Session's *cy-près* jurisdiction is expressly preserved,<sup>28</sup> and circumstances such as initial failure which fall outwith the "reorganisation conditions" continue to require to be dealt with by a common law application.

6.9 The consequence of the various statutory interventions described above is that there are now five different procedures for variation of the terms of a public trust, as follows:

(i) If the trust is charitable (including an educational endowment whose governing body is a charity), and one or more of the "reorganisation conditions" in the Charities Act is met, an application for approval of a reorganisation scheme may be made to OSCR.

(ii) If the trust is a non-charitable public trust (other than an educational endowment), and one or more of the conditions in section 9 of the 1990 Act is met,<sup>29</sup> an application for approval of a reorganisation scheme may be made to the court.

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<sup>24</sup> Sections 39-43 are reproduced at Appendix A.

<sup>25</sup> Charities and Trustee Investment (Scotland) Act 2005, Sch 4, para 7(e), inserting a new exception in s 15(9) of the 1990 Act.

<sup>26</sup> *Ibid*, s 42(6) and s 43, the latter inserting a new subsection (4) in the Education (Scotland) Act 1980, s 122.

<sup>27</sup> *Ibid*, s 42(5).

<sup>28</sup> *Ibid*, s 42(4).

<sup>29</sup> Which are not precisely the same as those now applicable to charities.

(iii) In the case of a non-charitable public trust which is a small trust, a reorganisation scheme may be effected by a resolution of the trustees, advertised and intimated as described above.

(iv) If the trust is a non-charitable educational endowment, an application for approval of a scheme varying the terms of its governing instrument may be made to the court under the Education (Scotland) Act 1980.<sup>30</sup>

(v) If a trust, whether charitable or not, has failed in any of the circumstances described in paragraph 6.4 above, an application may be made to the *nobile officium* of the Court of Session for approval of a *cy-près* scheme.

6.10 It appears to us to be unsatisfactory that there should be so many different procedures for reorganisation of different types of public trust. In most cases, only one of the various possibilities will be competent. Yet the dividing line between charitable and non-charitable trusts can be fine. Moreover, the fact that it has been considered appropriate to replace the special regime for reorganisation of charitable educational endowments by the provisions of the Charities Act might indicate that there is little difference of substance between educational endowment trusts and other public trusts. We therefore consider that it would be desirable in principle for the criteria for approval of an application for reorganisation of public trusts to be as far as possible the same regardless of whether or not the trust is charitable and whether or not it is an educational endowment.

6.11 We also see advantages in broadening the scope of the statutory application procedure to encompass those circumstances where, currently, the only avenue available is an application to the *nobile officium* of the Court of Session for approval of a *cy-près* scheme. By this means the risk of selecting the wrong procedure for an application would be minimised.

### **Proposals for reform**

6.12 The need for public accountability indicates that it is desirable for the reorganisation of non-charitable public trusts to continue to be subject to external control, whether by the courts or by some other entity. The circumstances warranting reorganisation are likely to be similar to those relevant to charitable trusts: for example, that the trust purposes can no longer be given effect, or that they are adequately provided for by other means, or that for some other reason they have ceased to provide a suitable and effective method of using the trust property.<sup>31</sup> The options for reform appear to be as follows:

(a) Leave the law as it is, subject to the Lord Advocate identifying a supervisory authority in relation to non-charitable public trust reorganisations to carry out the

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<sup>30</sup> Although the provisions of the 1980 Act apply only to property "dedicated to charitable purposes", it is conceivable that there will be educational endowments which do not fall within the scope of the Charities Act. In the 1980 Act, "charitable purposes" is to be construed in the same way as if it were contained in the Income Tax Acts (s 122(1)), whereas in order to be a charity for the purposes of the Charities Act, the body in question must meet the "charity test" in s 7, which includes the requirement that it provides "public benefit" in Scotland or elsewhere. An endowment might meet the income tax test but its governing body might fail the charity test, leaving the endowment subject to the provisions of the 1980 Act which are not identical to those of the Charities Act.

<sup>31</sup> Cf 1990 Act, s 9(1); Charities Act, s 42(2).

duties which have in the past been performed on his behalf by the Scottish Charities Office;

(b) Create a mechanism, parallel to that created for charities by the Charities Act, for extra-judicial approval of reorganisations of non-charitable public trusts, including educational endowments which fail to meet the charity test;

(c) Create a mechanism for extra-judicial approval of reorganisations of non-charitable public trusts which would also encompass matters which presently require application to the court for approval of a *cy-près* scheme;

(d) Confer power upon the trustees of all non-charitable public trusts to effect reorganisations by passing a resolution, perhaps after public advertisement but without the involvement of the court or any supervisory authority.

6.13 The last of the above options seems unsatisfactory. There would be no independent scrutiny of the trustees' reorganisation procedure and no-one would have authority to direct the trustees not to proceed if there had been irregularities in the passing of the resolution or in its advertisement. Persons who wished to challenge the validity of the trustees' determination would require to do so by ordinary court process. This appears to us to be a backward step and we do not favour this option. In our view there remains a need for external scrutiny of public trust reorganisations even where the trust is not a charity.

6.14 As between options (a) and (b), the choice depends upon whether a greater proportion of trust reorganisations ought to be relieved of the need to apply to the court for approval. In principle it seems desirable that they should be so relieved if an appropriate mechanism can be put in place. Our provisional view is that there should be consistency between the regimes for reorganisation of charitable and of public non-charitable trusts. It would lead to confusion if different conditions applied to the two categories, especially when, as we have observed, there is sometimes a very narrow distinction to be drawn as to what is or is not charitable. Between options (a) and (b) above, we would therefore provisionally favour option (b), namely the creation for non-charitable trusts of an extra-judicial approval procedure equivalent to that contained in the Charities Act for charitable trusts. The circumstances in which the purposes of non-charitable trusts could be reorganised without court involvement would mirror those contained in section 42(2) of the Charities Act, except that there would be no need for the "reorganisation condition" in section 42(2)(a)(iii), namely that some or all of the purposes of the trust have ceased to be charitable purposes.

#### *"Small" trusts*

6.15 In relation to "small" trusts, with regard to which an extra-judicial mechanism for reorganisation already exists, we have noted that the role of OSCR renders such special provisions unnecessary in relation to charitable trusts. The same would be so in relation to public non-charitable trusts if a parallel regime for extra-judicial approval of reorganisations were to be created. We have not therefore regarded it as necessary to consider whether sections 10 and 11 of the 1990 Act require any detailed amendment, although we would welcome comment on whether there are any particular features of these sections which have given rise to difficulty in practice.

### *Educational endowments*

6.16 As noted above,<sup>32</sup> reorganisation of educational endowments which are charities is now regulated by the provisions of the Charities Act and not, as previously, by the Education (Scotland) Act 1980. It would similarly be possible to bring into a new parallel regime for non-charitable public trusts any educational endowments which meet the "charitable" requirement for income tax purposes, and hence fall within the scope of the 1980 Act, but which do not meet the "charity test" under the Charities Act. This approach would have the merits of consistency and simplicity. On the other hand, we observe that the circumstances in which a scheme may be approved under the 1980 Act are broader than those set out in the Charities Act. In particular, the "reorganisation conditions" in the Charities Act assume, as did the provisions of the 1990 Act, that there is something wrong with the existing trust purposes which needs to be fixed. No such assumption underlies the equivalent provisions in the 1980 Act, and so the mechanism in that Act can be used simply to improve or update a scheme which has not yet run into significant operational difficulties, for example by adding new provisions to it. It may be that to apply provisions equivalent to those contained in the Charities Act to all educational endowments would be to introduce a restriction upon the options available to them for reorganisation of their schemes. We have reached no concluded view on whether it is desirable to replace the 1980 Act provisions with a new regime equivalent to that contained in the Charities Act, and we would welcome comment.

### *Extension of statutory jurisdiction to cases of initial failure*

6.17 The remaining option identified in paragraph 6.12 above (option (c)) is intended to address the fact that there is currently no statutory procedure for those matters which require *cy-près* schemes. As we have observed, the *cy-près* jurisdiction covers three situations:

- where a gift is made for public purposes but the trustor has failed to supply the necessary mechanism to carry it out;
- where there is an initial failure such as a bequest to a non-existent or defunct institution, or a direction which is impossible to carry out, but where the trustor has evinced a "general charitable intention"; and
- where there is a supervening failure after the bequest has taken effect, and there is no destination-over specified by the trustor for the eventuality of such failure.

Most cases of supervening failure will fall within the scope of the statutory reorganisation provisions. We are concerned primarily with the first two situations, namely defects which prevent the trust purposes from taking effect. Under option (c), a mechanism would be created for approval of reorganisations of non-charitable public trusts which would encompass such cases. We see advantages in broadening the scope of the statutory mechanism to cover initial failure of public trusts, as well as those circumstances presently falling within the scope of the 1990 Act. In our view it is unsatisfactory that there should be certain cases where an application under the statute is incompetent and others where only an application under the statute is competent.

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<sup>32</sup> Para 6.8.

6.18 Bringing all applications within the statutory basis would, if it were considered appropriate, enable the drafting of new criteria to be applied by the court in deciding whether or not to grant an application. Under the existing law, the court will not apply the *cy-près* doctrine in cases of initial failure unless the terms of the bequest evince a general charitable intention, as opposed to an intention to benefit only a specific body or purpose.<sup>33</sup> Where, for example, a bequest is made to a defunct institution, it is more difficult to establish a general charitable intention than in the case of a bequest to an institution which has never existed. If no such intention can be established, the bequest will lapse and the subject matter will fall into residue or intestacy, as the case may be. There has been much case law on whether the terms of particular bequests evinced the necessary general charitable intention. If a statutory test were to be introduced, it may be that the best approach would be to preserve the authority of that case law (which applies ordinary rules of testamentary construction) by adopting the existing common law requirement of "general charitable intention" without attempting to define it further. Alternatively, a new statutory test could be devised which was more specific as to the circumstances in which a scheme could be approved. For example, the test could be expressed negatively, so that the court, or an officer empowered to approve a scheme extra-judicially,<sup>34</sup> would approve the scheme unless satisfied that the trustor did *not* intend to benefit any body or purpose other than one named in the will or other document in question.

6.19 There is a significant practical difference between cases of initial failure on the one hand and reorganisation of existing public trusts on the other. In the former case there may be persons (such as those who will benefit if the bequest lapses) with a personal interest to oppose the application for approval of a scheme. Clearly their interests must be accommodated in any extra-judicial procedure for determination of the question whether the terms of a bequest evince the necessary charitable intention. It may indeed be thought that this is a matter which should simply be left to the court. If on the other hand it is to be determined extra-judicially by the supervisory authority for public trusts, we propose that the legislation should make provision, in cases of difficulty, for the matter to be referred to the court by the officer in question. Alternatively, or additionally, the legislation could make provision for an appeal to the court by an interested party who is dissatisfied with the officer's decision to treat the bequest as evincing a general charitable intention and to approve a scheme giving effect to that intention.

6.20 A disadvantage of option (c) is that if nothing further were done it would create a statutory regime for non-charitable public trusts which differed from, and was broader than, the regime for charitable trusts under the Charities Act. That would be regrettable for the reasons discussed in paragraph 6.17 above. The obvious solution would be to apply our proposal to charitable trusts as well as to non-charitable public trusts. A comprehensive procedure along these lines would be our preferred option if the statutory scheme is to be extended to include cases of initial failure.

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<sup>33</sup> The various tests which have been formulated are set out in Wilson and Duncan, *Trusts, Trustees and Executors* (2<sup>nd</sup> edn, 1995), para 15-04.

<sup>34</sup> See para 6.23 below.

6.21 We invite comment on the following proposals and questions:

13. **A new mechanism for extra-judicial approval of reorganisation of non-charitable public trusts should be created, which would be available both**
  - (i) **in the circumstances in which the Charities and Trustee Investment (Scotland) Act 2005 provides for reorganisation of charitable trusts; and**
  - (ii) **in the circumstances in which the *cy-près* jurisdiction is currently exercised by the court in relation to public trusts generally.**
14. **Should the new provisions extend to reorganisation of educational endowments, in place of section 105 of the Education (Scotland) Act 1980?**
15. **Should the circumstances in which an application may be made under the statutory procedure for reorganisation of a *charitable* trust be extended to include the circumstances in which the *cy-près* jurisdiction is currently exercised by the court?**
16. **Should the criteria for approval of a scheme to rectify an initial failure of trust purposes be defined with a view to retaining the existing common law requiring a general charitable intention, or is there a need for a change in the existing law as to the circumstances in which such a scheme should be approved?**

6.22 It would remain competent, as an alternative, to apply to the *nobile officium* of the Court of Session for approval of a *cy-près* scheme. We see no reason to exclude this jurisdiction. It is to be hoped, however, that the new provisions would prove themselves to be sufficiently useful and flexible that there would no longer be any need to apply to the *nobile officium*, and that the *cy-près* jurisdiction would in due course become obsolete.

#### **Who would be responsible for approving reorganisation schemes?**

6.23 We noted above<sup>35</sup> the view of the Scottish Executive that it was not appropriate for the Office of the Scottish Charity Regulator ("OSCR") to oversee the reorganisation of non-charitable trusts. Purely as a matter of nomenclature, it would indeed seem odd for a charity regulator to be given powers in relation to bodies which were not charities as defined by the relevant legislation. If, then, OSCR is not to be granted powers of approval of reorganisation schemes in relation to non-charitable public trusts, then a separate overseer would be required. We do not think that this function should be conferred upon local authorities for two reasons: firstly, because many public trusts will have nationwide activities, and to seek to tie them to a particular local authority could raise problems of jurisdiction and of consistency; and secondly, because in many cases the local authority (or its members or officials) will be the trustee, or among the trustees, of the trust, and not therefore in a position to consider the matter independently. We suggest that it should be for the Lord

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<sup>35</sup> See para 6.3.

Advocate to appoint an overseer to fulfill the same function as that fulfilled by OSCR for charities. Given that the Lord Advocate currently has responsibility (under section 10 of the 1990 Act) for supervising extra-judicial "small" non-charitable trust reorganisations, this would not necessarily amount to the creation of an additional office: our proposals would merely widen the scope for reorganisation of non-charitable trusts without the need for a court application.

6.24 It may be that this function could be added to the duties of an existing supervisory authority. An attractive alternative solution would be for the function to be delegated by the Lord Advocate to an officer within OSCR, albeit wearing a different, non-charitable, supervisory hat. If the legislation relative to non-charitable public trusts were to be aligned with that relative to charities, it seems to us that it would make sense for the same personnel to be dealing with both, albeit under different statutory authorities. This could be especially valuable in relation to scrutiny of cases of initial failure. It would be desirable for OSCR to have some involvement in the process of approval of a scheme to resolve an initial failure problem in order to avoid a situation where a trust whose scheme has been approved by the appropriate authority, or by the court, is then refused registration by OSCR as a charity. The fact that in addressing cases concerned with initial failure the official would not be acting as an officer of OSCR would eliminate any concern that the charity regulator was being asked to perform duties in relation to a trust whose charitable status had not previously been determined. Given the relatively small number of non-charitable public trusts, it seems unlikely that this would amount to a substantial additional burden for OSCR.

6.25 We invite views in response to the following question:

17. **Who should have responsibility for receiving and approving extra-judicial applications for reorganisation of non-charitable public trusts, including cases of initial failure in which the *cy-près* jurisdiction is currently exercised by the court?**

## Part 7 List of Proposals and Questions

1. It should be confirmed by statute that where all the persons with an interest, whether vested or contingent, in property held in trust are of full age and capacity, they may agree, without the need to obtain court approval of the agreement, either:
  - (a) to vary the purposes for which the trust property is held; or
  - (b) to terminate the trust and to require the trustees to make over the trust property to them in such shares as they may agree.

(Paragraph 4.9)

2. (1) Should legal representatives have power to consent to a variation or termination of a trust on behalf of a child who is incapable of consenting on his own behalf?
  - (2) If so, is there a need for protection of a child against the actings of a legal representative with a conflict of interest; for example
    - (a) by specifying the matters in respect of which the legal representative would require to be satisfied before giving consent?
    - (b) by excluding the possibility of such consent where there is a conflict of interest between the child and the legal representative?
    - (c) by permitting such consent where there is a conflict of interest only where the arrangement is also consented to by the trustees, including at least one disinterested trustee?
    - (d) by requiring approval of the variation by the Accountant of Court?
    - (e) by some other means?

(3) If option (c) were to be chosen, is there a need to specify the remedy available to a child where a variation proceeds on the basis of the consent of the legal representative, despite the existence of a conflict of interest?

(Paragraph 4.17)

3. (1) Beneficiaries aged 16 or 17 should have full capacity to consent to the variation or termination of a trust.
  - (2) (a) Should the right of challenge, after attaining age 18, of a beneficiary aged 16 or 17 at the time of consent be excluded?
  - (b) Should the trustees be required to satisfy themselves that a beneficiary aged 16 or 17 has received independent advice?

- (c) Alternatively, should approval by the Accountant of Court of the beneficiary's consent be required?

(Paragraph 4.21)

4. Where a woman who, prior to 1984, created an alimentary interest in her own favour in an ante-nuptial contract of marriage wishes to vary or terminate that interest, authorisation by the court under section 1(4) of the Trusts (Scotland) Act 1961 should no longer be required.

(Paragraph 4.25)

5. (1) Section 1(1) of the Trusts (Scotland) Act 1961 should be amended to permit the court to approve an arrangement notwithstanding the possibility of prejudice to an unborn or unascertained beneficiary, provided that the court is of the opinion that there is no reasonable likelihood that the interest of that person will come into existence.

(2) Is there another formulation which is preferable to "no reasonable likelihood" in expressing the statutory test, or, alternatively, is there a need for more detailed guidance as to the criteria for satisfaction of the statutory test?

(Paragraph 5.20)

6. (1) Should the court be empowered to grant an order exonerating the trustees from liability to all beneficiaries, whether or not of full age and capacity, whose interests at the time of the application are so remote as to be of negligible value?

(2) Is there a need for a statutory definition of an interest of negligible value?

(Paragraph 5.25)

7. Should the legislation be amended to make clear that in assessing the question of prejudice, the court may have regard to factors other than financial advantage or disadvantage to the beneficiary in question?

(Paragraph 5.30)

8. It should remain competent to apply to the court for approval of an arrangement on behalf of a beneficiary upon whose behalf consent could, in terms of our other proposals, also be given by a legal representative or other person.

(Paragraph 5.32)

9. Section 1 of the 1961 Act should be amended to permit the court to approve an arrangement on behalf of a person whose continued existence or whereabouts cannot, despite reasonable steps having been taken, be established, provided that the court is satisfied that the proposed arrangement would not be prejudicial to that person's interests.

(Paragraph 5.34)

10. (1) Should it remain necessary to obtain the consent of all ascertained and traceable beneficiaries of full age and capacity, provided that they have a non-negligible interest in the trust?
- (2) Alternatively, should the court be empowered to approve an arrangement on behalf of a non-consenting beneficiary of full age and capacity, provided that the court is satisfied that that beneficiary is not prejudiced by the arrangement?
- (3) If alternative (2) is preferred, should there be an additional requirement to be fulfilled that the proposed arrangement is not inconsistent with the wishes of the trust, or that it is in the interests of the beneficiaries as a whole, or some other requirement?
- (Paragraph 5.37)
11. Is there a need to extend the right to make an application in Scotland to persons other than the trustees and the beneficiaries?
- (Paragraph 5.39)
12. Is there a need to specify in the legislation that an arrangement may take the form of a re-settlement of the whole or part of the trust estate?
- (Paragraph 5.43)
13. A new mechanism for extra-judicial approval of reorganisation of non-charitable public trusts should be created, which would be available both
- (i) in the circumstances in which the Charities and Trustee Investment (Scotland) Act 2005 provides for reorganisation of charitable trusts; and
- (ii) in the circumstances in which the *cy-près* jurisdiction is currently exercised by the court in relation to public trusts generally.
- (Paragraph 6.21)
14. Should the new provisions extend to reorganisation of educational endowments, in place of section 105 of the Education (Scotland) Act 1980?
- (Paragraph 6.21)
15. Should the circumstances in which an application may be made under the statutory procedure for reorganisation of a *charitable* trust be extended to include the circumstances in which the *cy-près* jurisdiction is currently exercised by the court?
- (Paragraph 6.21)

16. Should the criteria for approval of a scheme to rectify an initial failure of trust purposes be defined with a view to retaining the existing common law requiring a general charitable intention, or is there a need for a change in the existing law as to the circumstances in which such a scheme should be approved?

(Paragraph 6.21)

17. Who should have responsibility for receiving and approving extra-judicial applications for reorganisation of non-charitable public trusts, including cases of initial failure in which the *cy-près* jurisdiction is currently exercised by the court?

(Paragraph 6.25)

# Appendix A

## TRUSTS (SCOTLAND) ACT 1961, SECTION 1

### Jurisdiction of court in relation to variation of trust purposes

1 (1) In relation to any trust taking effect, whether before or after the commencement of this Act, under any will, settlement or other disposition, the court may if it thinks fit, on the petition of the trustees or any of the beneficiaries, approve on behalf of –

(a) any of the beneficiaries who [because of any legal disability]<sup>1</sup> by reason of nonage or other incapacity is incapable of assenting, or

(b) any person (whether ascertained or not) who may become one of the beneficiaries as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, so however that this paragraph shall not include any person who is capable of assenting and would be of that description, or a member of that class, as the case may be, if the said date had fallen or the said event had happened at the date of the presentation of the petition to the court, or

(c) any person unborn,

any arrangement (by whomsoever proposed, and whether or not there is any other person beneficially interested who is capable of assenting thereto) varying or revoking all or any of the trust purposes or enlarging the powers of the trustees of managing or administering the trust estate:

Provided that the court shall not approve an arrangement under this subsection on behalf of any person unless it is of the opinion that the carrying out thereof would not be prejudicial to that person.

(2) For the purposes of the foregoing subsection a person who is [of or over the age of 16 years]<sup>2</sup> but has not attained the age of [18 years]<sup>3</sup> shall be deemed to be incapable of assenting: but before approving an arrangement under that subsection on behalf of any such person the court shall take account as it thinks appropriate of his attitude to the arrangement.

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<sup>1</sup> Amended by the Age of Legal Capacity (Scotland) Act 1991, s 10(1), Sch 1, para 27.

<sup>2</sup> *Ibid.*

<sup>3</sup> Amended by the Age of Majority (Scotland) Act 1969, s 1(3), Sch 1, Pt 1.

(3) [...]⁴

(4) Where under any trust such as is mentioned in subsection (1) of this section a trust purpose entitles any of the beneficiaries (in this subsection referred to as ‘the alimentary beneficiary’) to an alimentary liferent of, or any alimentary income from the trust estate or any part thereof, the court may if it thinks fit, on the petition of the trustees or any of the beneficiaries, authorise any arrangement varying or revoking that trust purpose and making new provisions in lieu thereof, including, if the court thinks fit, new provision for the disposal of the fee or capital of the trust estate or, as the case may be, of such part thereof as was burdened with the liferent or the payment of the income:

Provided that the court shall not authorise an arrangement under this subsection unless –

(a) it considers that the carrying out of the arrangement would be reasonable, having regard to the income of the alimentary beneficiary from all sources, and to such other factors, if any, as the court considers material, and

(b) the arrangement is approved by the alimentary beneficiary, or, where the alimentary beneficiary is a person on whose behalf the court is empowered by subsection (1) of this section or that subsection as extended by subsection (2) of this section to approve the arrangement, the arrangement is so approved by the court under that subsection.

(5) Nothing in the foregoing provisions of this section shall be taken to limit or restrict any power possessed by the court apart from this section under any Act of Parliament or rule of law.

(6) In this section the expression ‘beneficiary’ in relation to a trust includes any person having, directly or indirectly, an interest, whether vested or contingent, under the trust.

## **LAW REFORM (MISCELLANEOUS PROVISIONS)(SCOTLAND) ACT 1990, SECTIONS 9 - 11**

### **Reorganisation of public trusts by the court**

9 (1) Where, in the case of any public trust, the court is satisfied--

(a) that the purposes of the trust, whether in whole or in part--

(i) have been fulfilled as far as it is possible to do so; or

(ii) can no longer be given effect to, whether in accordance with the directions or spirit of the trust deed or other document constituting the trust or otherwise;

(b) that the purposes of the trust provide a use for only part of the property available under the trust;

(c) that the purposes of the trust were expressed by reference to -

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<sup>4</sup> Repealed by the Age of Legal Capacity (Scotland) Act 1991, s 10(2), Sch 2.

(i) an area which has, since the trust was constituted, ceased to have effect for the purpose described expressly or by implication in the trust deed or other document constituting the trust; or

(ii) a class of persons or area which has ceased to be suitable or appropriate, having regard to the spirit of the trust deed or other document constituting the trust, or as regards which it has ceased to be practicable to administer the property available under the trust; or

(d) that the purposes of the trust, whether in whole or in part, have, since the trust was constituted -

(i) been adequately provided for by other means; or

(ii) ceased to be such as would enable the trust to become a recognised body; or

(iii) ceased in any other way to provide a suitable and effective method of using the property available under the trust, having regard to the spirit of the trust deed or other document constituting the trust,

the court, on the application of the trustees, may, subject to subsection (2) below, approve a scheme for the variation or reorganisation of the trust purposes.

(2) The court shall not approve a scheme as mentioned in subsection (1) above unless it is satisfied that the trust purposes proposed in the scheme will enable the resources of the trust to be applied to better effect consistently with the spirit of the trust deed or other document constituting the trust, having regard to changes in social and economic conditions since the time when the trust was constituted.

(3) Where any of paragraphs (a) to (d) of subsection (1) above applies to a public trust, an application may be made under this section for the approval of a scheme -

(a) for the transfer of the assets of the trust to another public trust, whether involving a change to the trust purposes of such other trust or not; or

(b) for the amalgamation of the trust with one or more public trusts,

and the court, if it is satisfied that the conditions specified in subsection (2) above are met, may approve such a scheme.

(4) Subject to subsection (5) below, an application for approval of a scheme under this section shall be made to the Court of Session.

(5) From such day as the Lord Advocate may, by order, appoint, an application for approval of a scheme under this section may be made by a public trust having an annual income not exceeding such amount as the Secretary of State may, by order, prescribe -

(a) to the sheriff for the place with which the trust has its closest and most real connection;

(b) where there is no such place as is mentioned in paragraph (a) above, to the sheriff for the place where any of the trustees resides;

(c) where neither paragraph (a) nor (b) above applies, to the sheriff of Lothian and Borders at Edinburgh.

(6) Every application under this section shall be intimated to the Lord Advocate who shall be entitled to enter appearance as a party in any proceedings on such application, and he may lead such proof and enter such pleas as he thinks fit; and no expenses shall be claimable by or against the Lord Advocate in any proceedings in which he has entered appearance under this subsection.

(7) This section shall be without prejudice to the power of the Court of Session to approve a cy près scheme in relation to any public trust.

### **Small trusts**

10 (1) Where a majority of the trustees of any public trust having an annual income not exceeding £5,000 are of the opinion -

(a) that the purposes of the trust, whether in whole or in part -

(i) have been fulfilled as far as it is possible to do so; or

(ii) can no longer be given effect to, whether in accordance with the directions or spirit of the trust deed or other document constituting the trust or otherwise;

(b) that the purposes of the trust provide a use for only part of the property available under the trust;

(c) that the purposes of the trust were expressed by reference to -

(i) an area which has, since the trust was constituted, ceased to have effect for the purpose described expressly or by implication in the trust deed or other document constituting the trust; or

(ii) a class of persons or area which has ceased to be suitable or appropriate, having regard to the spirit of the trust deed or other document constituting the trust, or as regards which it has ceased to be practicable to administer the property available under the trust; or

(d) that the purposes of the trust, whether in whole or in part, have, since the trust was constituted -

(i) been adequately provided for by other means; or

(ii) ceased to be such as would enable the trust to become a recognised body; or

(iii) ceased in any other way to provide a suitable and effective method of using the property available under the trust, having regard to the spirit of the trust deed or other document constituting the trust,

subsection (2) below shall apply in respect of the trust.

(2) Where this subsection applies in respect of a trust, the trustees may determine that, to enable the resources of the trust to be applied to better effect consistently with the spirit of the trust deed or other document constituting the trust -

- (a) a modification of the trust's purposes should be made;
- (b) the whole assets of the trust should be transferred to another public trust; or
- (c) that the trust should be amalgamated with one or more public trusts.

(3) Where the trustees of a trust determine as mentioned in subsection (2)(a) above, they may, subject to subsections (4) to (6) below, pass a resolution that the trust deed be modified by replacing the trust purposes by other purposes specified in the resolution.

(4) The trustees shall ensure that, so far as is practicable in the circumstances, the purposes so specified are not so far dissimilar in character to those of the purposes set out in the original trust deed or other document constituting the trust that such modification of the trust deed would constitute an unreasonable departure from the spirit of such trust deed or other document.

(5) Before passing a resolution under subsection (3) above the trustees shall have regard -

- (a) where the trust purposes relate to a particular locality, to the circumstances of the locality; and
- (b) to the extent to which it may be desirable to achieve economy by amalgamating two or more trusts.

(6) As regards a trust which is a recognised body, the trustees shall ensure that the purposes specified as mentioned in subsection (3) above are such as will enable the trust to continue to be granted an exemption from tax by the Commissioners of Inland Revenue under section 505(1) of the Income and Corporation Taxes Act 1988 (exemption from tax for charities).

(7) Subject to subsection (14) below, a modification of trust purposes under this section shall not have effect before the expiry of a period of two months commencing with the date on which any advertisement in pursuance of regulations made under subsection (13) below is first published.

(8) Where the trustees determine as mentioned in subsection (2)(b) above they may pass a resolution that the trust be wound up and that the assets of the trust be transferred to another trust or trusts the purposes of which are not so dissimilar in character to those of the trust to be wound up as to constitute an unreasonable departure from the spirit of the trust deed or other document constituting the trust to be wound up.

(9) Before passing a resolution under subsection (8) above, the trustees shall -

(a) where the trust purposes relate to a particular locality, have regard to the circumstances of the locality;

(b) where the trust is a recognised body, ensure that the purposes of the trust to which it is proposed that the assets be transferred are such as will enable the trust to be granted an exemption from tax by the Commissioners of Inland Revenue under section 505(1) of the Income and Corporation Taxes Act 1988 (exemption from tax for charities); and

(c) ascertain that the trustees of the trust to which it is proposed to transfer the assets will consent to the transfer of the assets.

(10) Where the trustees determine as mentioned in subsection (2)(c) above, they may pass a resolution that the trust be amalgamated with one or more other trusts so that the purposes of the trust constituted by such amalgamation will not be so dissimilar in character to those of the trust to which the resolution relates as to constitute an unreasonable departure from the spirit of the trust deed or other document constituting the last mentioned trust.

(11) Before passing a resolution under subsection (10) above, the trustees shall -

(a) where the trust purposes relate to a particular locality, have regard to the circumstances of the locality;

(b) where any of the trusts to be amalgamated is a recognised body, ensure that the trust purposes of the trust to be constituted by such amalgamation will be such as to enable it to be granted an exemption from tax by the Commissioners of Inland Revenue under section 505(1) of the Income and Corporation Taxes Act 1988 (exemption from tax for charities); and

(c) ascertain that the trustees of any other trust with which it is proposed that the trust will be amalgamated will agree to such amalgamation.

(12) Subject to subsection (14) below, a transfer of trust assets or an amalgamation of two or more trusts under this section shall not be effected before the expiry of a period of two months commencing with the date on which any advertisement in pursuance of regulations made under subsection (13) below is first published.

(13) The Secretary of State may, by regulations, prescribe the procedure to be followed by trustees following upon a resolution passed under subsection (3), (8) or (10) above, and such regulations may, without prejudice to the generality, include provision as to advertisement of the proposed modification or winding up, the making of objections by persons with an interest in the purposes of the trust, notification to the Lord Advocate of the terms of the resolution and the time within which anything requires to be done.

(14) If it appears to the Lord Advocate, whether in consideration of any objections made in pursuance of regulations made under subsection (13) above or otherwise -

(a) that the trust deed should not be modified as mentioned in subsection (3) above;

(b) that the trust should not be wound up as mentioned in subsection (8) above; or

(c) that the trust should not be amalgamated as mentioned in subsection (10) above,

he may direct the trust not to proceed with the modification or, as the case may be winding up and transfer of funds or amalgamation.

(15) The Secretary of State may, by order, amend subsection (1) above by substituting a different figure for the figure, for the time being, mentioned in that subsection.

(16) This section shall apply to any trust to which section 223 of the Local Government (Scotland) Act 1973 (property held on trust by local authorities) applies.

### **Expenditure of capital**

11 (1) This section applies to any public trust which has an annual income not exceeding £1,000 where the trust deed or other document constituting the trust prohibits the expenditure of any of the trust capital.

(2) In the case of any trust to which this section applies where the trustees -

(a) have resolved unanimously that, having regard to the purposes of the trust, the income of the trust is too small to enable the purposes of the trust to be achieved; and

(b) are satisfied that either there is no reasonable prospect of effecting a transfer of the trust's assets under section 10 of this Act or that the expenditure of capital is more likely to achieve the purposes of the trust,

they may, subject to subsection (3) below, proceed with the expenditure of capital.

(3) Not less than two months before proceeding to expend capital, the trustees shall advertise their intention to do so in accordance with regulations made by the Secretary of State and shall notify the Lord Advocate of such intention.

(4) If it appears to the Lord Advocate that there are insufficient grounds for the expenditure of capital he may apply to the court for an order prohibiting such expenditure, and if the court is satisfied that there are such insufficient grounds it may grant the order.

(5) The Secretary of State may, by order, amend subsection (1) above by substituting a different figure for the figure, for the time being, mentioned in that subsection.

## EDUCATION (SCOTLAND) ACT 1980, SECTION 105

### Schemes for reorganisation of educational endowments

105 (1) Subject to the provisions of this section, [an education authority, whether upon an application made to them or not, may, if they think fit,]<sup>5</sup> prepare draft schemes for the future government and management of educational endowments, which schemes may provide -

(a) for altering the purposes to which such endowments are applied or applicable and the conditions and provisions regarding such application;

(b) for the application of the capital or income of such endowments to such educational purposes, mental or physical, moral or social, as the [education authority think]<sup>6</sup> fit having regard to the public interest and to existing conditions, social and educational: Provided always that the capital of any such endowment shall not be expended except on a purpose to which capital may properly be devoted;

(c) for grouping, amalgamating, combining or dividing any such endowments;

(d) for altering the constitution of the governing body of any such endowment, or uniting two or more existing governing bodies or establishing new governing bodies with such powers as shall seem necessary, and for incorporating any governing body, whether old or new, and for dissolving any governing body whose endowment is transferred to another governing body; and

(e) for altering the powers as to the investment of the funds of any such endowment.

[Provided that in considering whether to exercise, in relation to any endowment, the power conferred upon them by this subsection an education authority may have regard to whether the exercise of the power would prejudice the proper discharge by them of their functions under this Act apart from this section or their functions as local authority under any enactment.]<sup>7</sup>

(2) It shall be the duty of the [education authority]<sup>8</sup> in reorganising any endowment in pursuance of the powers conferred by this Part of this Act to have special regard -

(a) to the spirit of the intention of the founders as embodied either -

(i) in the original deed constituting the endowment where it is still the governing instrument, or

(ii) in the scheme approved under any Act, or in any provisional order affecting the endowment;

(b) to the interest of the locality to which the endowment belongs;

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<sup>5</sup> Words substituted with savings by the Education (Scotland) Act 1981, Sch 6, para 4(a).

<sup>6</sup> Words substituted with savings by the Education (Scotland) Act 1981, Sch 6, para 4(b).

<sup>7</sup> Inserted by the Education (Scotland) Act 1981, Sch 6, para 4(d).

<sup>8</sup> Words substituted with savings by the Education (Scotland) Act 1981, Sch 6, para 4(c).

(c) to the possibility of effecting economy in administration by the grouping, amalgamation or combination of any two or more endowments; and

(d) to the need for continuing the provision from endowments of competitive bursaries at universities, central institutions, colleges of education or other educational institutions of a similar character.

(3) In every scheme which abolishes or modifies any privileges or educational advantages to which a particular class of persons is entitled, whether as inhabitants of a particular area or as belonging to a particular class in life or otherwise, the [education authority]<sup>9</sup> shall have regard to the educational interests of such class of persons:

Provided always that, where the governing instrument of any educational endowment has expressly provided for the education of children belonging to the poorer classes, either generally or within a particular area, or otherwise for their benefit, such endowment for such education or otherwise for their benefit shall continue, so far as requisite, to be applied for the benefit of such children.

(4) The powers of the [education authority]<sup>10</sup> under this section shall not extend -

(a) to a university endowment, or

(b) to the Carnegie Trust, or

(c) to a theological endowment, or

(d) to a new endowment,[or

(e) to an endowment which relates in whole or in part to an educational establishment not managed by the education authority who would, but for this paragraph, be empowered under this section to exercise in relation to that endowment the functions conferred by this section, or

(f) to an educational endowment having no limitation either as to the area in which any educational establishment to which it relates is situated or as to the area in which any of its beneficiaries are required under its governing instrument to reside or with which they are so required to have some other connection.]<sup>11</sup>

[Provided that this subsection shall not apply to an endowment which falls within paragraph (e) above solely by reason of the inclusion among its purposes of the award of prizes, bursaries or similar benefits to persons who attend or have attended educational establishments or other institutions not managed by an education authority.]<sup>12</sup>

[(4A) The Court of Session shall have power, on the petition of -

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<sup>9</sup> Words substituted with savings by the Education (Scotland) Act 1981, Sch 6, para 4(c).

<sup>10</sup> Words substituted with savings by the Education (Scotland) Act 1981, Sch 6, para 4(c).

<sup>11</sup> Inserted by the Education (Scotland) Act 1981, Sch 6, para 4(e).

<sup>12</sup> Substituted by the Education (Scotland) Act 1981, Sch 6, para 4(f).

(a) the governing body of any endowment to which subsection (4) above applies or, in the case of the Carnegie Trust, the Trustees;

(b) in relation to an endowment to which paragraph (e) of that subsection applies and which relates only in part to an educational establishment not managed by the education authority referred to in that paragraph, the education authority, in respect of the part of the endowment in relation to which they would, but for the said paragraph (e), be empowered under this section to exercise the functions conferred by this section,

to give effect to draft schemes for the future government and management of the endowment or, as the case may be, the Trust, which schemes may provide for any of the purposes set out in paragraphs (a) to (e) of subsection (1) above and, in exercising the power conferred on it under this subsection, the Court shall have special regard to the matters specified in paragraphs (a) to (d) of subsection (2) above.

(4B) Where a petition under subsection (4A) above relates to an endowment to which paragraph (e) of subsection (4) above applies and which relates only in part to an educational establishment not managed by the education authority referred to in that paragraph the Court of Session shall, before making an order under the said subsection (4A)—

(a) where the petition was presented by any body referred to in paragraph (a) of the said subsection (4A), cause the petition to be served on the education authority;

(b) where the petition was presented by an education authority under paragraph (b) of the said subsection (4A), cause the petition to be served on the governing body of the endowment to which the petition relates.

(4C) The governing body of an endowment in relation to which an education authority are empowered under this section to exercise the functions conferred by this section may, if the authority refuse to exercise their power under subsection (1) above in relation to the endowment on the ground that such exercise would prejudice the proper discharge by them of their functions under this Act apart from this section or their functions as local authority under any enactment, present a petition to the Court of Session, and subsections (4A), (4B) and (4D) of this section shall apply to such a petition.]<sup>13</sup>

(4D) [ ]<sup>14</sup>

(5) [...] <sup>15</sup>

(6) After 30th June 1976 any reference in a scheme made or approved under Part VI of the Act of 1946 or under Part VI of the Act of 1962 (reorganisation of educational endowments) -

(a) to a certificated teacher shall be construed as a reference to a teacher registered under the Teaching Council (Scotland) Act 1965;

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<sup>13</sup> Inserted by the Education (Scotland) Act 1981, Sch 6, para 4(g).

<sup>14</sup> Repealed by Charities and Trustee Investment (Scotland) Act 2005, Sch 3, para 6.

<sup>15</sup> Repealed with savings by the Education (Scotland) Act 1981, Sch 6, para 4(h) and Sch 9.

(b) to a children's committee shall be construed as a reference to a social work committee established under section 2(1) of the Social Work (Scotland) Act 1968;

(c) to the Scottish Counties of Cities Association or to the Association of County Councils in Scotland shall be construed as a reference to the Convention of Scottish Local Authorities.

[(7) In this section, "education authority" means, in relation to an educational endowment, the education authority for the area in which any educational establishment to which the endowment relates is situated or, where the endowment relates to no particular such establishment, the education authority for the area in which the beneficiaries of the endowment are required under its governing instrument to reside or with which they are so required to have some other connection.]<sup>16</sup>

## **CHARITIES AND TRUSTEE INVESTMENT (SCOTLAND) ACT 2005, SECTIONS 39 - 43**

### **Reorganisation of charities: applications by charity**

39 (1) OSCR<sup>17</sup> may, on the application of a charity, approve a reorganisation scheme proposed by the charity if it considers -

(a) that any of the reorganisation conditions is satisfied in relation to the charity, and

(b) that the proposed reorganisation scheme will -

(i) where the condition satisfied is that set out in paragraph (a) or (b) of section 42(2), enable the resources of the charity to be applied to better effect for charitable purposes consistently with the spirit of its constitution, having regard to changes in social and economic conditions since it was constituted, or

(ii) where the condition satisfied is that set out in paragraph (c) of that section, enable the charity to be administered more effectively.

(2) The Scottish Ministers may by regulations make such provision as they think fit in relation to the procedure for applying for and determining applications under this section.

(3) Such regulations may in particular make provision about -

(a) the form and manner in which applications must be made,

(b) the period within which OSCR must make a decision on an application,

(c) publication of proposed reorganisation schemes,

and may make different provision in relation to different types of charity.

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<sup>16</sup> Inserted by Education (Scotland) Act 1981, Sch 6, para 4(i).

<sup>17</sup> Office of the Scottish Charity Regulator.

## **Reorganisation of charities: applications by OSCR**

40 (1) Where OSCR considers -

- (a) that any of the reorganisation conditions is satisfied in relation to a charity, and
- (b) that a reorganisation scheme proposed by it or by the charity trustees of the charity will -
  - (i) where the condition satisfied is that set out in paragraph (a) or (b) of section 42(2), enable the resources of the charity to be applied to better effect for charitable purposes consistently with the spirit of its constitution, having regard to changes in social and economic conditions since it was constituted, or
  - (ii) where the condition satisfied is that set out in paragraph (c) of that section, enable the charity to be administered more effectively,

OSCR may, of its own accord or on the application of the charity trustees of the charity, apply to the Court of Session for approval of the scheme.

(2) The Court of Session may, on an application under subsection (1), approve the proposed reorganisation scheme if it considers that the matters set out in paragraphs (a) and (b) of that subsection are satisfied in relation to the charity to which the application relates.

(3) The charity trustees of a charity may enter appearance as a party in proceedings on an application under subsection (1) in relation to the charity.

(4) OSCR must, not less than 28 days before making an application under subsection (1), notify the charity in question of its intention to do so.

### **Approved schemes**

41 A charity may, despite any provision of its constitution having contrary effect, proceed with any variation, transfer or amalgamation for which an approved reorganisation scheme makes provision.

### **Reorganisation: supplementary**

42 (1) This section applies for the interpretation of Chapter 5.

(2) The "reorganisation conditions" are -

- (a) that some or all of the purposes of the charity -
  - (i) have been fulfilled as far as possible or adequately provided for by other means,
  - (ii) can no longer be given effect to (whether or not in accordance with the directions or spirit of its constitution),
  - (iii) have ceased to be charitable purposes, or

(iv) have ceased in any other way to provide a suitable and effective method of using its property, having regard to the spirit of its constitution,

(b) that the purposes of the charity provide a use for only part of its property, and

(c) that a provision of the charity's constitution (other than a provision setting out the charity's purposes) can no longer be given effect to or is otherwise no longer desirable.

(3) A "reorganisation scheme" is a scheme for -

(a) variation of the constitution of the charity (whether or not in relation to its purposes),

(b) transfer of the property of the charity (after satisfaction of any liabilities) to another charity (whether or not involving a change to the purposes of the other charity), or

(c) amalgamation of the charity with another charity.

(4) Nothing in section 40 affects the power of the Court of Session to approve a cy près scheme in relation to a charity.

(5) Sections 39 and 40 do not apply to any charity constituted under a Royal charter or warrant or under any enactment.

(6) But, despite subsection (5), those sections do apply to an endowment if its governing body is a charity.

(7) In subsection (6), "endowment" and "governing body" have the same meaning as in Part 6 (reorganisation of endowments) of the Education (Scotland) Act 1980 (c.44).

## **Endowments**

43 In section 122 (interpretation of Part 6) of the Education (Scotland) Act 1980 (c.44), after subsection (3) insert -

"(4) This Part, apart from section 104, does not apply in relation to any endowment the governing body of which is a charity within the meaning of section 106 of the Charities and Trustee Investment (Scotland) Act 2005 (asp 10)."

# Appendix B

## UNIFORM TRUST CODE, SECTIONS 410-412

### 410. MODIFICATION OR TERMINATION OF TRUST; PROCEEDINGS FOR APPROVAL OR DISAPPROVAL.

(a) In addition to the methods of termination prescribed by Sections 411 through 414, a trust terminates to the extent the trust is revoked or expires pursuant to its terms, no purpose of the trust remains to be achieved, or the purposes of the trust have become unlawful, contrary to public policy, or impossible to achieve.

(b) A proceeding to approve or disapprove a proposed modification or termination under Sections 411 through 416, or trust combination or division under Section 417, may be commenced by a trustee or beneficiary, [and a proceeding to approve or disapprove a proposed modification or termination under Section 411 may be commenced by the settlor]. The settlor of a charitable trust may maintain a proceeding to modify the trust under Section 413.

### 411. MODIFICATION OR TERMINATION OF NONCHARITABLE IRREVOCABLE TRUST BY CONSENT.

[(a) [A noncharitable irrevocable trust may be modified or terminated upon consent of the settlor and all beneficiaries, even if the modification or termination is inconsistent with a material purpose of the trust.] [If, upon petition, the court finds that the settlor and all beneficiaries consent to the modification or termination of a noncharitable irrevocable trust, the court shall approve the modification or termination even if the modification or termination is inconsistent with a material purpose of the trust.] A settlor's power to consent to a trust's modification or termination may be exercised by an agent under a power of attorney only to the extent expressly authorized by the power of attorney or the terms of the trust; by the settlor's [conservator] with the approval of the court supervising the [conservatorship] if an agent is not so authorized; or by the settlor's [guardian] with the approval of the court supervising the [guardianship] if an agent is not so authorized and a conservator has not been appointed. [This subsection does not apply to irrevocable trusts created before or to revocable trusts that become irrevocable before [the effective date of this [Code] [amendment].]]

(b) A noncharitable irrevocable trust may be terminated upon consent of all of the beneficiaries if the court concludes that continuance of the trust is not necessary to achieve any material purpose of the trust. A noncharitable irrevocable trust may be modified upon consent of all of the beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust.

[(c) A spendthrift provision in the terms of the trust is not presumed to constitute a material purpose of the trust.]

(d) Upon termination of a trust under subsection (a) or (b), the trustee shall distribute the trust property as agreed by the beneficiaries.

(e) If not all of the beneficiaries consent to a proposed modification or termination of the trust under subsection (a) or (b), the modification or termination may be approved by the court if the court is satisfied that:

(1) if all of the beneficiaries had consented, the trust could have been modified or terminated under this section; and

(2) the interests of a beneficiary who does not consent will be adequately protected.

#### 412. MODIFICATION OR TERMINATION BECAUSE OF UNANTICIPATED CIRCUMSTANCES OR INABILITY TO ADMINISTER TRUST EFFECTIVELY.

(a) The court may modify the administrative or dispositive terms of a trust or terminate the trust if, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust. To the extent practicable, the modification must be made in accordance with the settlor's probable intention.

(b) The court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration.

(c) Upon termination of a trust under this section, the trustee shall distribute the trust property in a manner consistent with the purposes of the trust.

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## Appendix C Advisory Group on Trust Law

Mr Alan Barr	University of Edinburgh, Solicitor, Edinburgh
Mr Robert Chill	Solicitor, Edinburgh
Mr Andrew Dalgleish	Solicitor, Edinburgh
Mr Frank Fletcher	Solicitor, Glasgow
Mr A F McDonald	Solicitor, Dundee
Mr Simon A Mackintosh	Solicitor, Edinburgh
Mr James McNeill QC	Advocate, Edinburgh
Mr Allan Nicolson	Solicitor, Edinburgh
Professor Kenneth Norrie	University of Strathclyde
Mr Scott Rae	Solicitor, Edinburgh
Mr Mark Stewart	Secretary, Society of Trust and Estate Practitioners (Scotland)
Mr Alister Sutherland	Consultant Solicitor
Dr David Nichols (Secretary)	Scottish Law Commission





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