



TRUSTS OF FAMILY BUSINESSES: HISTORICAL AND MODERN PERSPECTIVES

ANDREAS TELEVANTOS

ABSTRACT

This paper examines how the device of the “trust” can be used in common law systems to preserve family business assets. At a broad level, it examines the common law’s rules which sought to prevent restrictions on the alienation of assets and shows how these rules could be subverted using the device of a trust. It then looks at a particular example of this subversion in the context of family businesses. It shows how, historically, it was common for testators in their wills to settle business assets on trust for children, ultimately making provision for children to take over the business. Such a device could allow a settlor control over how the family business was run after their death and even provide a degree of limited liability trading protection to their children: before limited liability was recognised more generally. Turning to contemporary practice, it considers the conceptual issues surrounding trusts of businesses today, in particular, the difficulties trading trusts can create for creditors and in the insolvency context.

Keywords: trusts, restraints on alienation, insolvency, legal history, creditors.

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This short chapter addresses the theme of the volume – instruments for preserving the unity of family businesses – by looking at trusts of family businesses in England and the Commonwealth today and historically. It comprises three main parts. Part 1 provides an overview of English legal history’s confused approach to the kinds of restraints on alienation which can help preserve the integrity of family property. Part 2 sets out English law’s rules restraining limits imposed on the free alienability of property. Part 3 explains what a trust is; how trusts could be used to circumvent rules limiting restraints on alienation; and the flexibility of this doctrinal form. Part 4 then moves on to look at the historical use of trusts in family businesses in England in the eighteenth and nineteenth centuries. Part 5 then examines how lawyers today have taken inspiration from this historical model to create “trading trusts” for family businesses, which are particularly popular in jurisdictions like Australia. It also considers the problems such trusts can cause.

1. AN INTRODUCTION TO RESTRAINTS ON ALIENATION IN ENGLISH LAW

Like other legal systems discussed in this volume, the development of English property law can be seen as the product of a tug-of-war between different conceptions of property. On one hand, we have the liberal conception of property, according to which property is freely alienable, circulates within the market with standardised incidents,¹ and can be claimed by creditors in satisfaction of outstanding debts. On the other hand, we have feudal and dynastic ideas of property, whereby a legal system allows a property owner to impose bespoke conditions and limitations on its use or disposition by his descendants, thereby ensuring that the property will remain within the family for generations. The most famous example of the latter is the so-called “strict settlement”, through which the property of wealthy English families was passed intact between generations in the seventeenth,

1 For a modern theoretical discussion, see Merrill, 2012.

eighteenth, and nineteenth centuries.² Nonetheless, English law lacked a coherent policy regarding the extent to which property could be subject to such encumbrances. As Joshua Getzler explains:³

English law across the centuries seems to have run contradictory policies simultaneously: land holders could use limitations and trusts to entail their property and proof it from judgments, but the law also created actions facilitating the assignment of real interests and allowing recovery of debts against land and trusts. English law was thus a mixture of pro-creditor and pro-debtor norms, of rules for free assignment and rules allowing property to be removed from the operation of the market. Moreover, the law in operation was so opaque, so lacking in clear, rational rules, that it was difficult and costly to work out which policy applied. And how to operate the machinery in any given circumstance.⁴

2. RULES PROMOTING FREE ALIENABILITY OF PROPERTY IN ENGLISH LAW

As Getzler acknowledges, English law historically had several rules intended to encourage the free alienability of property and its circulation in the market. First, English law has historically recognised a “rule against repugnancy”, which prevented restrictions on future alienation being placed on estates in land.⁵ Similarly, the rules against mortmain dispositions imposed restrictions on donating land to the church, which might hold it forever. Originally, Magna Carta only prohibited dispositions to the church to evade feudal incidents,⁶ but later alienations to religious houses were banned.⁷

2 See e.g. Habbakuk, 1994.

3 Getzler, 2009.

4 Ibid., p. 357.

5 Co. Litt. at 223a; Bl. Comm. Vol. II at 156. See e.g. *Brandon v Robinson* (1811) 18 Ves. Jun. 429, 34 E.R. 37 (Ch.); *Re Rosher* (1884) 26 Ch. D. 801 at 812 (Ch.).

6 Magna Carta (1215) c. 36.

7 Statute *De viris religiosus* (1279).

English law also had a restrictive approach to attempts to settle property on descendants without power of alienation, as a way of keeping property within a family indefinitely. The Statute *De Donis* of 1285⁸ did allow land to be entailed – so, for instance, a gift in tail restricted to A and the heirs male of his body would pass the land to male descendants, none of whom would have the power to alienate the land.⁹ However, lawyers devised a way to allow those who took land under an entail to “bar” the entail, thereby allowing an heir to sell it. Typically, this was done by way of a collusive court action between purchaser and vendor called a “common recovery” – where a court order would give the purchaser good title to the land.¹⁰ Further, the rule against perpetuities limited the effectiveness of dispositions designed to provide for several generations. At common law, a will bequeathing an estate in land to an unborn person, with a remainder to that person’s future children, would be void as a perpetuity.¹¹ As Anderson explains, “The common law allowed only one generation of unborn persons to inherit”.¹² Further, any executory interests in movables or immovables created by a disposition had to vest within the perpetuity period.¹³

It is clear, then, that English law had plenty of rules protecting the free alienability of property. Indeed, it is notable that even under the strict settlement, family property would need to be resettled every generation – the eldest son of the settlor, if he came of age during the father’s lifetime, would need to be induced not to break the settlement. This pressure would often come from his bride’s family upon marriage.¹⁴

Finally, English law also limited attempts to put assets beyond the reach of creditors, including the Elizabethan statutes on fraudulent conveyances, 13 Eliz I c 5 (1571) and 27 Eliz I c 4 (1584-5). Both these

8 Statute *De Donis*, Stat. Westminster II (1285) c. 1.

9 Baker, 2019, pp. 293–294.

10 *Ibid.*, pp. 300–303.

11 E.g. see *Whitby v. Mitchell* (1890) 44 Ch. D. 85 (Ch.).

12 Anderson, 2010a, pp. 18–19.

13 *Ibid.*, pp. 19–20, noting that what this period was changed over time. For an example of the historical rule see *Cadell v. Palmer* (1832) 1 Cl. & F. 372. For the modern position see the Perpetuities and Accumulations Act 2009.

14 Baker, 2019, p. 314.

statutes allowed certain dispositions of property – dispositions made fraudulently to avoid creditors¹⁵ or to make preferences,¹⁶ and voluntary settlements of land, respectively¹⁷ – to be challenged by creditors and donees of the disponent unless made for “good consideration”. During the eighteenth century, courts came to interpret these statutes more strictly – they came for the first time to treat “good consideration” as requiring the payment of value.¹⁸ Another such restriction was the reputed ownership rules under statute 21 Jac 1 c 19, section 10. This provided that personal property in the possession of a bankrupt debtor would vest in their bankrupt estate – essentially prohibiting non-possessory security of personality.¹⁹ As Willems argues, this rule seems to have had a civilian origin.²⁰ As with the Elizabethan statutes, this reputed ownership doctrine also came to be treated as stricter in the eighteenth century, when judges stopped treating fraudulent intent as necessary to engage the statute.²¹

We can see then, on its face, English law showed a considerable commitment to a more liberal version of property law – one under which property was freely alienable and available to creditors. This picture though is an incomplete one because, as Getzler recognizes above, these rules could be avoided by using an appropriately drafted trust.

- 15 The disposition would have to be for value and bona fide to avoid the statute. Actual fraud was required to trigger the statute, and a sale at an undervalue would not per se be fraudulent, though it might evidence fraud; see *Copis v. Middleton* (1818) 2 Madd. 410, 56 E.R. 386 (Ch.).
- 16 *Twyne's case* (1601) Co. Rep. 80, 76 E.R. 809 (K.B.); *Alderson v. Temple* (1768) 4 Burr. 2235, 98 E.R. 165; 1 Wm. Bl. 660, 96 E.R. 384 (K.B.).
- 17 *Doe d. Otley v. Manning* (1807) 9 East 59, 103 E.R. 495 (K.B.); *Buckle v. Mitchell* (1812) 18 Ves. Jun. 100, 34 E.R. 255 (Ch.).
- 18 Getzler and Macnair, 2005, pp. 263–265.
- 19 21 Jac. 1 c. 19 (Bankrupts Act 1623–24), s. 10.
- 20 Willems, 2015.
- 21 The landmark case was *Ryall v. Rolle* (1750) 1 Ves. Sen. 348, 27 E.R. 1074; 1 Atk. 165, 26 E.R. 107; 1 Wils. K.B. 260, 95 E.R. 607 (H.L.). For further discussion see Televantos, 2020, pp. 123–128.

3. WHAT IS A TRUST?

At its most simple, a trust is a legal institution for the holding of property, distinct from company law or agency. It functions as a way of dividing up the typical incidents of ownership in a manner not possible in most legal systems that do not recognise trusts – and it does so generally without the need for registration or extensive formalities.²²

Historically, trusts evolved out of the division between courts of law and equity in England. Originally, England had courts of law only, which would administer the king's justice, as embodied in the common law. However, the Chancery, which originated as the royal secretariat rather than a court, eventually emerged as a distinct legal jurisdiction.²³ This jurisdiction seems to have evolved principally from bills of complaint made to the King's Council when the petitioner could not obtain relief in the royal courts.²⁴ Bills of complaint were dealt with by the Chancellor, who came to issue process and grant remedies himself.²⁵ While the Chancellor in such cases was not originally seen as applying a body of law – he was granting ad hoc relief according instead to “conscience” – the decisions of Chancery ultimately evolved into a body of jurisprudence known as “equity”.²⁶ This body of rules was “supplementary” to the common law, as F.W. Maitland put it: “*we ought to think of equity as supplementary law, a sort of appendix added on to our code, or a sort of gloss written around our code, an appendix, a gloss*”.²⁷

This flowed from the fact that suits in equity were brought when a suitor could not obtain justice in the common law courts. Chancery would often order the holders of common law rights to use them in

22 In English law only declarations trust of land need to be “manifested and proved” in signed writing, see Law of Property Act 1925, s. 53(1)(b), substantively re-enacting the Statute of Frauds 1677 (29 Car. 2 c. 3), s. 7.

23 Baker, 2019, p. 107.

24 Maitland and Brunyate, 1939, pp. 4–5.

25 Baker, 2019, pp. 109–110.

26 Ibid., pp. 114–116, 118–119; Maitland and Brunyate, 1939, pp. 9–10. Note too that equity was also administered by other courts, in particular the equity side of the exchequer (see e.g. Bryson, 1975).

27 Maitland and Brunyate, 1939, p. 18.

particular ways.²⁸ For instance, in cases of fraud, a person with legal rights might be ordered to transfer their rights to another or be restrained from exercising those rights in particular ways, on penalty of imprisonment.

The Chancery emerged as “inseverably connected with the Trust”.²⁹ Maitland saw Chancery’s intervention here as arising in response to the medieval common law’s refusal to recognise a will of land.³⁰ As such, it came to enforce bargains where a father transferred an estate in land to a friend on the understanding that the friend would convey the estate to the father’s children upon the father’s death. Such an arrangement was later interpreted as creating a trust over the land.³¹ The terms of the agreement between the father (the settlor) and his friend (the trustee) determined how and in what way the settlor’s children were to benefit from the trust. Importantly for our purposes, trusts originated as a form of contract, Chancery came to enforce them against an increasing number of people, and so an interest under a trust came to resemble a proprietary right. Maitland famously explained that development in the following way:

In this development we may trace several logical stages:

- (I) *The first is reached when the cestui que trust (beneficiary) has a remedy against the person who has undertaken to hold land or goods on trust for him.*

28 For a modern theoretical discussion of the implications of this today, see Smith, 2021.

29 Maitland, 2004b, p. 84.

30 Ibid.; Baker, 2019, pp. 285–288. The position was changed by statute but only in the Tudor period, by the Statute of Wills 1549 (32 Hen VIII c 1).

31 Originally these arrangements were called “uses”. In Henry VIII’s time “passive” uses of land, those under which the trustee agreed to act as a passive custodian, were by statute “executed”, thus giving legal title to the land to the intended beneficiary; see the Statute of Uses 1536, 27 Hen. VIII, c. 10. However, later lawyers devised a way of bypassing the statute through using the device of a “use upon a use”, in relation to which the second use was not executed. These became trusts, and the extent to which they were the same as the earlier uses is controversial. For discussion, see Jones 2002.

- (II) *The second step is easy. The use or trust can be enforced against those who come to the land or goods by inheritance or succession from the original trustee [...] Such persons may be regarded as sustaining wholly or partially the person of the original trustee and being bound by his obligations as regards the proprietary rights to which they have succeeded.*
- (III) *The third step is to enforce the trust against the trustee's creditors [...]*
- (IV) *[...] The right of the cestui que trust was enforced against any person who came to the thing [held on trust] through or under the trustee as a volunteer – i.e. without valuable consideration, even though he had no notice of the trust.*
- (V) *[...] The trust was enforced against one who purchased the thing from the trustee if he at the time of the conveyance knew of the trust [...]*
- (VI) *[...] We arrive then at this result, equitable rights will hold good even against one who has come to the legal ownership by purchase for value, if when he obtained the legal ownership [from the trustee] he had express or constructive notice of those rights [i.e. he knew, or ought to have known about the trust].³²*

In other words, beneficiaries of a trust have rights against both the trustee and third parties.³³ Originally Chancery only enforced the trust against the person who had agreed to hold assets on trust (stage (I)),³⁴ but it soon came to enforce the trust against those who inherited the trust assets from the original trustee (stage (II)) and indeed his creditors (stage (III)). This latter point means that a trustee's creditors cannot levy execution against trust assets,³⁵ nor, if the trustee becomes bankrupt, do the trust assets vest in his bankrupt estate.³⁶ Instead, the beneficiaries will be able to claim the assets, either taking a transfer of them directly or having them transferred to a new trustee. The key point is

32 Maitland, 1939, pp. 112–114.

33 Nolan, 2007.

34 See e.g. *Re Massingberd's Settlement; Clark v Trelawney* (1890) 63 L.T. 296 (Ch.D.).

35 For a very early example, see Lord Nottingham LK's judgement in *Medley v Martin* (1673) Rep. t. Finch 63; 23 E.R. 33 (Ch.).

36 *Re Morgan* (1881) 18 Ch. D. 93, 101 (Ch.).

that beneficiaries are not treated as unsecured creditors of the trustee. Finally, where a trustee disposed of the assets without authority under the trust's terms to a third party, the beneficiary could recover the asset from that third party who had not paid the trustee value (stage (IV)), had paid value but knew of the trust (stage (V)), or ought to have known of the trust (stage (VI)). The famous Oxford jurist Peter Birks described this claim as the equitable equivalent of the *vindicatio* in Roman law.³⁷ Further, today, a beneficiary of a trust is not only able to “follow” trust assets into the hands of disponees but also “trace” substitutes of these assets held either by the original trustee or a donee and claim those substitutes as part of the trust fund. This is justified by reference to the beneficiary's property right in the original trust assets.³⁸

In that way beneficiaries' equitable rights appeared proprietary. However, Maitland considered this “resemblance to rights *in rem*”³⁹ to be “misleading”,⁴⁰ in particular, since a good faith purchaser for value of legal title without notice will take free of prior equitable interests.⁴¹ While Maitland's argument still has some academic support,⁴² the proprietary language remains very common.⁴³

This combination of rules is important in understanding the trust's ability to subvert the common law's restrictions on imposing fetters on the free disposition of property. By declaring a trust, a settlor was able to create bespoke property-like interests in both movables and immovables without infringing the common law rules that prevented the imposition of restrictions on powers of alienation. The extent of a settlor's ability to create bespoke equitable proprietary interests has led Paul Matthews to argue that English law lacks a *numerus clausus* of property rights in the civilian sense.⁴⁴

37 Birks, 2000. See also McBride, 2016.

38 *Foskett v. McKeown* [2001] 1 A.C. 102 (H.L.).

39 The use of the term “rights” or “*ius in rem*” (in the accusative) as opposed to “*in re*” (in the ablative) is conventional in British scholarship.

40 Maitland, 1939, p. 117.

41 Fox, 2018.

42 See e.g. McFarlane and Stevens, 2010.

43 For a recent example of the equitable proprietary language, see *Byers v. Saudi Bank* [2023] U.K.S.C. 51.

44 Matthews, 2013.

Moreover, such control could manifest in various ways. The terms of a trust, for instance, could provide that a beneficiary's interest would only come into existence upon the occurrence of a condition precedent, or even that the beneficiary's interest will come to an end in favour of some other named party upon a specified event.⁴⁵ Rather differently, the terms would also serve as a management regime, outlining how the trustee was to invest the trust property, what payments were to be made from the fund and to whom, and how benefits were to be allocated between capital and income.

Crucially, it should be emphasised that the "proprietary" interests of beneficiaries do not generally allow them to disrupt the operation of the trust. The trust assets themselves are owned by the trustee. For that reason, if a third-party tortfeasor interferes with the goods, it is the trustee who must bring the claim, for it is the trustee's right to possession that has been interfered with,⁴⁶ though if the trustee fails to act, the beneficiaries may be able to compel them to do so,⁴⁷ provided a sufficient indemnity for the trustees is available.⁴⁸ The beneficiary's claim is rather different: the basic right of a beneficiary is to have the trust duly administered in accordance with the provisions of the trust instrument, if any, and the general law,⁴⁹ and beyond that they have no right to demand the trustees use their powers in any particular way.⁵⁰ Commentators have therefore conceived of a beneficiary's rights as a proprietary right to due administration of a fund.⁵¹ The only exception to the rule that beneficiaries are limited to what the terms of the trust give them is the rule in *Saunders v Vautier* (1841).⁵² This provides that, where all the beneficiaries of a trust are sui juris, they can collectively collapse the trust and call for the trust assets from the trustee.⁵³

45 Anderson, 2010b, pp. 246–268.

46 See e.g. *M.C.C. v Lehman* [1998] 4 All E.R. 675.

47 Under the procedure recognised in *Vandepitte v. Preferred Accident Insurance Co. of New York* [1933] A.C. 70.

48 *Concord Trust v. Law Debenture Trust Corporation* [2005] U.K.H.L. 27.

49 *Target Holdings Ltd. v. Redfems (A Firm)* [1996] A.C. 421, 434.

50 *Re Brockbank* [1948] Ch. 206.

51 See e.g. Nolan, 2004.

52 *Saunders v. Vautier* (1840) 4 Beav. 115, 41 E.R. 482; (1841) Cr. & Ph. 240 (Ch).

53 For discussion see Matthews, 2006.

The law of trusts therefore allows settlors the power to contractually tailor beneficial interests while, at the same time, giving those beneficiaries property-like protections of a kind which can very seldom disrupt the trust's operation. For this reason, trusts have been used in English legal history as "a liberal substitute for a law about personified institutions":⁵⁴ trusts have been used in the structure of the stock exchange, joint stock companies, the Inns of Court, charities, minority religious sects, social clubs, and family (strict) settlements.⁵⁵ As such, Maitland saw the trust as "the greatest and most distinctive achievement performed by Englishmen in the sphere of jurisprudence".⁵⁶

4. TRUSTS OF FAMILY BUSINESSES HISTORICALLY

We now turn to historical uses of trusts of family businesses, examining cases of what I've elsewhere called "testamentary trading trusts".⁵⁷ These made use of both the flexibility of trusts and their proprietary effects. While a considerable body of scholarship has examined the extent to which a trust of a business could be used historically in common law jurisdictions to emulate the effects of a joint stock corporation with limited liability and tradeable shares,⁵⁸ trusts of small family businesses historically have received far less attention. They are briefly described by Chantal Stebbings in *The Private Trustee in Victorian England*⁵⁹ as part and parcel of family trusts:

The second and most common form of trust was the family or mercantile trust. These trusts were [...] complex, often demanding a great deal of time and effort by the trustees, and requiring the exercise of discretion, for they necessitated the running of a business, or the supervision of the

54 Maitland, 2003a, p. 57.

55 Maitland 2003b.

56 Maitland, 2003a.

57 Televantos, 2020, pp. 53–55.

58 E.g. see Lobban, 2016, pp. 613–619; Getzler and Macnair, 2005; Harris, 2000, chs. 5 and 6; Morley, 2016.

59 Stebbings, 2002.

*education and upbringing of infant children as well as the management of the trust fund.*⁶⁰

How did such trusts work? Imagine we are in 1800, and a husband and wife run a business that supports their family. They have no substantial assets outside the business. They have an infant son, who they hope will take over the business when he grows up. The father is drafting his will and wants to make sure that the business continues to operate after his death so that his son can take it over.

A complicating factor is that the business is unincorporated. In England general incorporation was not introduced until the mid-nineteenth century, before then it was only available via Royal Charter or Act of Parliament, and was usually only granted to overseas trading companies (like the East India company) or for public infrastructure projects (such as navigating canals or building railways).⁶¹ What legal structure could a business owner use in his will to make sure the business continued to provide for his family after his death?

The most obvious solution would have involved a trust with the following terms:⁶² First, the business owner would appoint trustees to hold legal title to the trade assets for the benefit of the testamentary estate.⁶³ These trustees might be relatives or family friends. Second, the business owner would provide who was to run the business until his son reached 21 years of age.⁶⁴ The business would sometimes be run by the trustees themselves, but in other cases it might instead be run by the widow or a third-party manager. Thirdly, the will would provide that, until the eldest son reached 21 (or sometimes 25), the profits of the business would be used to discharge pre-existing trade debts and provide for the family.⁶⁵ Fourthly, upon reaching 21, the son was to have the option to purchase the trade assets from the trustees, typically on credit.⁶⁶ Finally, the

60 Stebbings, 2002, pp. 9–10.

61 Hunt, 1936, pp. 9–13, 22–29.

62 For more detail on this structure, see Televantos, 2020, pp. 53–55.

63 *Smith v. Starkey* (1825) P.R.O. C 33/736, ff. 1761r–1765v (Ch.).

64 *Stodhort v. Ryle* (1825) PRO C 333/736, ff. 2762r–64v, C 33/737, ff. 2025r–2026r (Ch.).

65 *Caffrey v. Darby* (1801) 6 Ves. Jun. 488, 31 ER 1159 (Ch.).

66 *Wilkinson v. Stafford* (1789) 1 Ves. Jun. 32, 30 ER 216 (Ch.).

purchase price of the business was to be used to provide dowries for daughters and make provision for younger sons.⁶⁷

This structure offered several benefits for business owners. The first was control: the business owner was able to keep the business trading as a going concern after death and even direct how the business was run. The second was that the structure allowed provision to be made for family members: where a business was the family's major source of wealth, the business could be charged with payment of sums to maintain the widow and other family members. Thirdly, the structure allowed flexibility. The trustees chosen by the testator could be given discretions to wind up or sell the business – for instance if the family needed money; if there was a market downturn; or if the trustees thought that the business owner's children were not fit to take over the trade.

Fourthly, and perhaps most importantly, the trust structure protected the family from creditor claims. Such trusts effectively allowed a form of limited liability trading, long before limited liability corporations were recognised by English law.⁶⁸ We see this from the case of *Ex parte Garland* (1804),⁶⁹ decided by Lord Eldon LC. On the facts, Henry Ballman owned a farm and mill. He created a trust of the business in his will. He appointed trustees to hold legal title to the business assets and appointed his wife as a manager to run the business, allowing her to take £600 from his other assets to use for business purposes. Henry Ballman died, and his widow ran the business until she was declared bankrupt – having used more than £2000 of estate assets to run the business. The surviving trustee of the business argued that the trade creditors should be allowed to be paid from Henry Ballman's remaining non-business assets. Because his testamentary estate had taken the profits of the business, it should be fully liable for its debts. In other words, the creditors of the business should be paid from the legacies Henry Ballman had left to his children.

Lord Eldon LC rejected this argument, ruling that the creditors had no claim. The business creditors had dealt with the widow, and so their

67 *Humble v. Bill* (1703) 2 Vern. 444, 23 E.R. 884 (Ch.).

68 *Televantos*, 2020, pp. 55–60.

69 *Ex p. Garland* (1804) 10 Ves. Jun. 110, 32 ER 786 (Ch.).

rights to Henry Ballman's estate were limited to hers. Furthermore, the will explicitly prohibited the widow from using more than £600 of the testamentary business. As the widow had already used more than this in the business, she had no claim against Henry Ballman's estate in respect of the business. The creditors could be in no better position than the widow, and so they had no claim against the estate, even though the estate had been taking the profits of the business. The historical trading trust therefore offered real advantages to business owners by allowing a form of limited liability trading before such trading was generally recognised by the law.⁷⁰

5. THE USE OF TRUSTS OF BUSINESSES TODAY

As we see above, historically much of the reason business assets were settled on trust was the lack of a generally available corporate law, and so it is perhaps surprising that such trusts exist today. Nuncio D'Angelo's book on *Commercial Trusts* identifies the basic form employed by such entities.⁷¹ Business owners create a limited liability corporation to act as a trustee. The business assets are then transferred to the corporation, which holds all the assets on discretionary trust for family members. The terms of the trust allow the corporation to trade with the assets and incur liabilities for the purposes of the business. The corporate trustee has no other assets except for trust assets – and so holds no property for its own benefit – and engages in no transactions except for those related to the business.

What are the advantages of this structure today? Why not simply incorporate the family business and have family members as shareholders in whose favour dividends can be declared? The possible advantages vary by jurisdiction. In Australia, where trading trusts are most common, the main motivator for this kind of structure in small family

70 By the Limited Liability Act 1855 (18 & 19 Vict. c. 133), replicated thereafter by the Joint Stock Companies Act 1856 (19 & 20 Vict. c. 47).

71 D'Angelo, 2014, Ch. 2.

businesses is tax.⁷² Essentially, paying family members as beneficiaries of a trust is more tax efficient than paying them as shareholders. Further, structuring a family business as a trust can involve fewer regulatory requirements – trusts involve no need to register or file accounts, though if the trustee is a corporation, obviously it will need to do this.⁷³

Finally, as we saw with historical trading trusts, a trust structure can provide protection from creditors. Specifically, a modern trust structure can even protect *business assets* from creditors in cases of mismanagement. This requires some explanation. As discussed earlier, creditors of a trustee *cannot* claim trust assets.⁷⁴ This principle includes “trust creditors” – where a business is held on trust, as a matter of law the creditors of the business are simply the personal creditors of the trustee.⁷⁵ As such, if they are unpaid, they cannot claim the trust assets directly. The underlying point is that the trust has no legal personality and cannot hold rights or liabilities independently of the trustee.⁷⁶ A trust, in civilian terms, does not classically constitute a separate patrimony, though it is sometimes described in that way.⁷⁷

That being said, a trustee who incurs liability with authority under the terms of the trust acquires a right to be indemnified from trust assets.⁷⁸ This means either that the trustee can use trust assets directly to pay the trust debts or, if the trustee pays the debts from his own beneficially held property, he can be reimbursed from the trust assets.⁷⁹ These are sometimes respectively called a power of exoneration and a power of recoupment.⁸⁰ This indemnity is important not only for the trustee but for creditors too. Trust creditors can claim trust assets by being “subrogated” to a trustee’s right of indemnity, so long as the

72 Evans, 2019.

73 D’Angelo, 2014, paras. [2.98]–[2.110].

74 *Medley v. Martin* (1673) Rep. t. Finch 63; 23 E.R. 33 (Ch.).

75 *Re Morgan* (1881) 18 Ch. D. 93 (Ch.).

76 *Re Johnson* (1880) 15 Ch. D. 548 (Ch.).

77 See e.g. Vaslan, 2015.

78 *Re Johnson* (1880) 15 Ch. D. 548 (Ch.).

79 *Carter Holt Harvey v. Commonwealth* [2019] H.C.A. 20 at [29] to [32].

80 See e.g. *Chief Commissioner of Stamp Duties (N.S.W.) v. Buckle* [1998] H.C.A. 4; (1998) 192 C.L.R. 226, paras. [47]–[50].

liability was incurred with authority under the terms of the trust.⁸¹ In other words, the trust creditors can indirectly claim trust assets through a trustee's right of indemnity.

However, there are severe limits on this mechanism. First, trust creditors cannot claim trust assets where the liability was incurred without authority under the terms of the trust – even if the trustee appeared to have authority to enter into the transaction.⁸² The underlying point here is that a trustee is not an agent or *procurator* of the beneficiaries, and so the doctrine of apparent authority does not apply simply because of the existence of a trust relationship.⁸³

Secondly, and perhaps more troublingly, a creditor might be unable to claim trust assets even where that creditor's claim is authorised by the terms of the trust. Where a trustee has committed an unrelated breach of trust and incurs liabilities to the beneficiaries in respect of that breach, any indemnity the trustee is entitled to is offset against the trustee's liability for breach – and so potentially extinguished altogether. Where a trustee's indemnity is destroyed in this way, the trust creditors are unable to claim trust assets at all. As Lord Hodge explains in *Investec v Glenalla Properties* (2018):⁸⁴

Because the creditor's recourse to the assets is derived from the trustee's right of indemnity, it is vulnerable. It is exercisable only to the extent that that right exists. It may be defeated if there are insufficient trust assets to satisfy his debt, or if the trustee's right of indemnity is defeated, for example because the debt was unreasonably or improperly incurred and the indemnity does not extend to such debts, or because the trust deed excludes it on account of the trustee's wilful default or gross negligence.

More generally, a breach of trust by the trustee, even in relation to a matter unconnected with the incurring of the relevant liability, will, to the extent

81 *Re Johnson* (1880) 15 Ch. D. 548, 552 (Ch.).

82 *Re Johnson* (1880) 15 Ch. D. 548, 552 (Ch.).

83 *Televantos*, 2016.

84 *Investec Trust (Guernsey) Ltd v. Glenalla Properties Ltd* [2018] U.K.P.C. 7.

*that it creates a liability to account on the part of the trustee, stand in the way of the enforcement of the indemnity.*⁸⁵

These rules can be particularly problematic for creditors of modern trading trusts. As above, where a business is run through a corporation which holds all its assets on trust, there are no assets for business creditors to claim other than trust assets. Accordingly, where a trading trustee acts in breach of trust, the creditors of the business might find there are no assets that they can claim at all. Concerns about these rules, have led to some academic arguments that the rules in this area are unjustifiable – and that a trustee’s unrelated breach should not affect creditor claims to trust assets.⁸⁶ For instance, D’Angelo argues there is a real risk of the law undermining normal commercial expectations in cases of this kind, given that such expectations today are invariably shaped by the very different risk allocation provided by corporate law.⁸⁷

By and large, judges tend to defend the existing rules, as Lord Hodge does in *Investec*:

*As has been frequently observed, this can be hard on the creditor, who will usually have no knowledge of the state of account between the trustee and the beneficiaries. But the creditor can, in principle, protect his position, for example, by taking a fixed charge over the trust assets or, as in the present case, by stipulating for a personal guarantee from the principal beneficiary.*⁸⁸

In other words – the fact that a creditor can contract for proprietary or personal security when dealing with a trustee means that the law does sufficiently allow trust creditors to protect themselves. Presumably, though, this reasoning is limited only to contract creditors; for instance, if a trustee incurs a tortious (i.e. delictual) liability while executing the

85 *Investec v. Glenalla Properties* [2018] U.K.P.C. 7 at [59](III) (per Lord Hodge).

86 See e.g. Ollikainen-Read, 2018, pp. 69–74.

87 D’Angelo (2014), para. [5.84].

88 Lord Hodge in *Investec v. Glenalla Properties* [2018] U.K.P.C. 7 at [59](III). See too *Equity Trust (Jersey) Ltd v Halabi (Jersey); ITG Ltd and Others v. Fort Trustees Ltd (Guernsey)* [2022] U.K.P.C. 36 at [257].

trust's terms, the victim certainly would not have been capable of bargaining for security. Likewise, should the trustee incur a liability in unjust enrichment in the execution of the trust, the claimant would never have been able to bargain for security.

Before finishing it is worth mentioning one final difficulty trusts of family businesses can give rise to in the insolvency context.⁸⁹ If a trading trustee becomes insolvent, do statutory insolvency distribution rules apply in respect of trust assets? So if the insolvency regime gives priority claims to certain kinds of employees of a bankrupt, for instance, do employees of a business held on trust have a priority claim upon the trustee's bankruptcy?⁹⁰ There is no English authority on point, but the leading trusts law textbook, *Lewin on Trusts*, says that the employees would not get a priority claim.⁹¹ The reasoning is that since trust assets do not vest in an insolvent trustee's estate, statutory rules of distribution are irrelevant. Trust assets should be distributed *pari passu* amongst trust creditors, without reference to any priority creditor claims conferred by the statutory insolvency regime.

However, in *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth*,⁹² the High Court of Australia ruled that the statutory rules of distribution would apply. The facts of the case concerned whether insolvency legislation should govern the priority of the distribution of the assets of a trading trust. In the leading judgment, Bell J, Gageler J, and Nettle J explained the position in the following way:

To the extent of [the trustees] right of indemnity, [the trust] property would have yielded proceeds of realisation from which [the trustee] would have been entitled to discharge properly incurred trust liabilities. [...] That

89 For deeper discussion of this point, see Televantos, 2025.

90 Such priority in English law exists for unpaid contributions to occupational pension schemes (Pension Schemes Act 1993 Sch.4; Insolvency Act 1986 Sch.6, para.8) and unpaid remuneration (Insolvency Act 1986 Sch.6, paras 9–15).

91 Tucker and Le Poidevin and Brightwell, 2023, para. [27–057].

92 *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* [2019] HCA 20

*property yielded proceeds of realisation from which the [...] [trustee] would have been, entitled to discharge properly incurred trust liabilities.*⁹³

Put differently, the trustee's right of indemnity permitted it to utilise trust assets to meet trust liabilities, for example, to meet debts owed by the trustee. Consequently, the assets subject to the indemnity vested in its insolvent estate. Additionally, those assets could only be distributed amongst trust creditors, and the priority of their distribution should be governed by the statutory priority regime. It is certainly hard to see, as a matter of policy, why the fact a business is settled on trust should make a difference to how the assets of the business are distributed amongst business creditors.

6. SUMMARY OF CONCLUSIONS

In conclusion, English law has long had an inconsistent approach to imposing restrictions on the free alienation of property. On the one hand, the common law had various rules against such restrictions, but the law of trusts allows those restrictions to be evaded. This is because trusts allow the creation of bespoke equitable proprietary interests which bind trustees, their creditors, and some disponees. A fortiori, the flexibility of the trust device means that it is possible to settle business assets on trust, the terms of which can allow the business to be run for the benefit of family members and managed flexibly. The trust structure can protect beneficiaries from creditors, especially in cases of mismanagement – thereby preserving the unity of business assets. In part, this explains the use of trusts in businesses historically and today. The deeper question, though, is whether this is desirable. The trust means that creditors of a business might be unable to claim business assets, especially as trust law shifts the risk of mismanagement onto creditors over owners, unlike corporate law. Trusts established by businesses serve as an excellent example of modern lawyers drawing inspiration

93 *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* [2019] HCA 20, para. [98].

from historical legal structures in family business planning, and they also exemplify how historical rules persist even as the surrounding world and legal system undergo significant changes.

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