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In the beginning, there was equity

The history of equity law and the trust concept

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Trusts are certainly an important part of the work of tax consultants on the island. Yet they are often misunderstood. The best way to become more familiar with the trust concept is to understand its historical background. This is the purpose of the present article.

A brief history of equity law and the trust concept

Settlors in Cyprus often are from countries where equity law does not apply to their legal framework, notably civil law jurisdictions, and as a result, they have an imperfect understanding of what is a trust. A prospective settlor may ask to see the law governing Cyprus International Trusts to understand it. Yet the law in itself offers very little guidance over the notion of the trust concept. Equity law restrains and restricts the exercise of legal rights and powers when it would be unconscionable for them to be exercised in full. This is a fundamental building block of what the trust is about. A comprehension of the law provides no such insights.

A trustee will take legal ownership of the trust fund. The trustee is said to be the owner in law and the beneficiary the owner in *equity*. The trustees' legal rights over the trust fund are subject to the beneficiaries' rights in it. As with most things, a better understanding of the trust notion is achieved through a comprehension of its historical origins. I note that Cyprus trust law follows the English system introduced as a result of the British Administration of the island between 1878 and 1960.

A brief history

The history of equity and by extension of trusts dates back to medieval England. Around the 12th century, King Henry I would assert his rule over his subjects by having his court move around the country, collecting taxes and delivering justice. In making his decisions the King and his Council would be advised by the King's Chancellor, who was usually a learned cleric. By the 13th century every decision the King took in one case of justice set a precedent for future reference.

It was around this time that the *use* of land began its existence. The *use* is for all intents and purposes the ancestor of the *trust*. The *use* was recognised by the Chancellor and was especially important during times of war. Where the rich persons of the land would leave the country to fight alongside the King, they would leave their lands in the name of a trusted friend for the *use* and benefit of the first person's wife and family – it was not possible then for a woman to own land.

By the early 14th century the King's common law was already well established. However the common law was rigid and subject to official but inflexible formalities. The Chancellor presided over individual cases where injustice would 'embarrass the King's conscience', and provide appropriate remedy. In fact, such remedy, which was at the time based on ecclesiastical morality, marked the birthstone of equity law.

Over the next two centuries, the court of the Chancellor grew in size and was permanently based in Westminster. Thus the Court of the Chancery found its base. Clerics were replaced by lawyers and the remedy passed down by the Chancellor on the grounds of conscience, was formally established as a branch of law – equity law. Over the same period the number of petitions also increased, that sought to counter the rigidness of the common law system, where justice could fail due to technicalities or formalities. If a decision of the common law courts was not seen to be equitable, a petition could be made to the Court of the Chancery.

Over the same period of time, the *use* became a widely used tool to separate the legal title of lands from their benefit so that the benefit of the land remained with the original owner who however avoided paying fees, which were levied by the Crown against title deeds.

During the 16th century, Henry VIII effectively abolished several *uses* by enacting the Statute of Uses, whereby if a use existed with a single beneficiary, the legal title would be transferred directly in the name of the beneficiary. This led, as is often the case, to creative ways of getting round the Statute.

The most important technique developed was the 'use upon a use'. In this case A would hold the land for the use of B who in turn would hold it for the use of C. The Statute would 'kill off' the first use, A to B. However B's use to C would still hold.

The Chancery came to recognise the 'use upon a use', which later became known as the trust. There existed a legal owner of a property title (the trustee) and an equitable owner of the property title (the beneficiary). The latter could enforce his equitable ownership against the former. An equitable right or interest had been established over the property title, which bounded it. Thus was created the foundation of the modern trust. The equitable title refers to the use and enjoyment of the property. The legal title refers to the actual ownership.

In many instances there were differences of opinion between the Court of the Chancery and the common law courts. Supporters of the common law courts would argue that decisions were based on precedent and thus provided certainty, which was placed in doubt as a result of the decisions of the Chancery. The counter argument was that certainty did not always result in justice, and the Chancery existed to act as a balance and correct instances of individual cases, where general common law principles were applied that resulted in hardship.

During the 17th century, disputes between the courts came to a head in the cases of *Heath v. Rydley* and *Courtney v. Granvil*, where the Court of the Chancery granted relief against both judgements.

The dispute between the Chief Justice and the Lord Chancellor was referred to the King himself. The year was 1616. King James I consulted his Council and on advice received from his Attorney-General,

Sir Francis Bacon, decided in favour of equity. It was thus established that where equity and common law conflicted, equity prevailed.

Over the next centuries, the English legal system saw the unification of the Chancery and the common law courts, although the two branches of law remained distinct. The modern trust doctrine was developed and statutory consolidation led to specific rules that governed the creation and operation of trusts. The trust was used widely to keep property within families for generations to come. Today the modern trust offers a much wider flexibility of use.

What started off in medieval history as a method to look after land, resulted in one of the most widely used tools in modern tax and estate planning.