

**For information
on 22 April 2013**

**Bills Committee on
Trust Law (Amendment) Bill 2013**

**Supplementary Information arising from
the Meeting on 9 April 2013**

PURPOSE

In response to Members' request at the third meeting of the Committee on 9 April 2013, this paper provides information on the considerations for the proposals to abolish the rule against perpetuities ("RAP") and the rule against excessive accumulations of income ("REA") with respect to new trusts¹.

BACKGROUND

RAP as applied in Hong Kong

2. RAP puts a time limit within which trust properties must vest in the beneficiaries. Under the common law, RAP, in gist, dictates that the future interest in trust properties must vest in the beneficiaries not later than 21 years after the determination of the last life in being at the time of the creation of such interest. If there is any possibility that the interest may vest outside that period, the interest fails from the outset.

3. The RAP under common law was modified by the Perpetuities and Accumulations Ordinance (Cap. 257) ("PAO"), which was modeled on the United Kingdom ("UK") Perpetuities and Accumulations Act 1964. The PAO contains provisions which seek to mitigate the strictness of the RAP under the common law. Among others, it introduces a "wait and

¹ Given the public nature of the needs that charitable trusts meet, it is proposed in the Bill to retain but simplify the restrictions on accumulations of income for charitable trusts so that the income will be applied for the intended charitable purposes. See the new section 3B of the Perpetuities and Accumulations Ordinance (Cap. 257).

see” rule such that the creation of a future estate or interest is not invalidated until it becomes apparent that the future estate or interest must vest outside the perpetuity period. On the other hand, PAO provides that settlors may choose a fixed perpetuities period of 80 years.

REA as applied in Hong Kong

4. A trust instrument may direct that the income of the trust be accumulated for a certain period and be distributed only at the end of that period. REA was introduced by the PAO as a statutory rule that restricts accumulation of income and it stipulates that settlors may choose one of the six statutory accumulation periods² for which the income of a trust may be accumulated.

CONSIDERATIONS FOR THE PROPOSED ABOLITION

5. The proposed abolition of the RAP and the REA for new trusts is based on the following considerations –

- (a) the need for the rules has diminished;
- (b) the rules are overly complex and their application would create uncertainties; and
- (c) abolition of the rules, and allowing settlors to set up perpetual trusts in Hong Kong, will enhance the attractiveness of Hong Kong as a trust domicile.

² Briefly, the six accumulation periods are, subject to certain conditions, -

- (a) the life of the settlor; or
- (b) a term of 21 years from the death of the settlor; or
- (c) the duration of the minority of any person in being at the death of the settlor; or
- (d) the duration of the minority only of any person who under the limitations of the instrument directing the accumulations would, for the time being, if of full age, be entitled to the income directed to be accumulated; or
- (e) a term of 21 years from the date of the making of the disposition; or
- (f) the duration of the minority of any person in being at the date of the making of the disposition.

Diminished need of the rules

RAP

6. The RAP has its origin in the UK in the consideration that it is against public policy to allow property, especially land, to be removed from the market. However, unlike other countries where freehold land exists, almost all private land in Hong Kong is leasehold land held from the Government with a fixed lease term, and the lease term for land granted after July 1997 is usually 50 years. In addition, if any private land is required for redevelopment purposes, there are several Ordinances³ which give a power of resumption or compulsory sale. Accordingly, in Hong Kong, the importance of RAP in ensuring that land would not be tied up for a certain outdated purpose has been reduced.

7. It should also be noted that trustees are under a duty to invest the trust fund⁴. Therefore the trust fund will be in a constant course of circulation in the market. Further, under common law, if all the beneficiaries are of full age and legal capacity and are absolutely entitled to the trust property, they may act together to terminate the trust. This means that the trust assets would not be kept from them against their will.

REA

8. It is noted that REA was introduced in the UK for the fear that a large portion of the nations' wealth may eventually fall into a few hands after a long accumulation period and threaten the power of the State. However, the fears were subsequently considered as unfounded and the UK has already abolished the REA in 2009⁵. We therefore consider that there is no case for Hong Kong to retain the REA. Further, the common law jurisdiction of the courts to declare a trust void for capriciousness might be used to invalidate any provision which directed accumulation without a rational purpose or for an unreasonable period.

³ For example, the Roads (Works, Use and Compensation) Ordinance (Cap.370), the Lands Resumption Ordinance (Cap.124) and the Land (Compulsory Sale for Redevelopment) Ordinance (Cap. 545).

⁴ Paragraph 35-01, Lewin on Trust (18th Edition)

⁵ Same as what we propose in the Bill (see footnote 1), the UK has retained certain restrictions on accumulations of income for charitable trusts.

Complexity of the rules and possible uncertainties

RAP

9. The RAP as applied in Hong Kong is overly complicated and can be difficult to apply in practice. If a fixed perpetuity period is not chosen for a trust and the period is defined by reference to some lives in being, the perpetuity period can be difficult to determine. Knowledge of the relevant case law and the effect of the PAO will be required to ascertain whether the relevant disposition would be void. This could create uncertainties concerning the validity of the trust. If a disposition is invalidated because of non-observance of the RAP, the property may be vested in someone whom a settlor had not intended to provide for and the settlor's wish would be frustrated, even though the wish may appear to be legitimate to the settlor when setting up the trust.

REA

10. The REA as applied in Hong Kong is also complicated, with six accumulation periods for the settlor to choose from and there are exceptions to the rule. In case there is an absence of a selection by the settlor, there will be uncertainties as one will have to apply to court to determine the relevant accumulation period. The uncertainty in the application of this rule can give rise to unnecessary litigation.

Enhancing Hong Kong's attractiveness as a trust domicile

11. We note that in comparable jurisdictions like the UK and Singapore, there are still fixed perpetuity periods. The proposal to abolish the RAP and the REA, thereby allowing the setting up of perpetual trusts, would therefore enhance Hong Kong's attractiveness as a trust domicile.

OVERSEAS EXPERIENCE

12. We note that many comparable jurisdictions have reformed or

abolished the RAP or REA. A comparison of the treatment of RAP and REA in some of these jurisdictions is at **Annex**.

PUBLIC CONSULTATION

13. We conducted a public consultation on the broad direction for modernizing the trust laws in 2009, in which we consulted the public whether the RAP and the REA should be abolished. A majority of the respondents supported their abolition⁶.

ADVICE SOUGHT

14. Members are invited to note the content of this paper.

Financial Services and the Treasury Bureau
17 April 2013

⁶ The consultation paper and the consultation conclusions are available at http://www.fstb.gov.hk/fsb/ppr/consult/to_review.htm

Comparison of Treatment of RAP and REA in Major Comparable Common Law Jurisdictions

	Hong Kong	United Kingdom	Singapore	Australia	New Zealand
RAP	Currently a fixed period not exceeding 80 years or 21 years after the termination of the last life in being; abolition proposed.	Fixed period not exceeding 125 years	Fixed period not exceeding 100 years	The subject is governed by state law; abolished in the state of South Australia	Fixed period not exceeding 80 years; extension to 150 years proposed
REA	Currently six statutory accumulations periods to choose from; abolition proposed.	Abolished	Abolished	The subject is governed by state law; abolished in the state of South Australia.	Abolished