Recovery of Social Care Costs by Local Authorities- Weaving a Tangled Web?

Public law meets trusts and conveyancing with a dash of bankruptcy thrown in!

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terra firma CHAMBERS

In this paper Scott will -

(1) ***give an update the ever contentious area of recovery of social care costs by local authorities arising from attempts by the family of a social care recipient to "protect the assets";***
(2) ***provide an overview of the use of discretionary trusts as a possible means of defending the family assets;***
(3) ***consider the use of insolvency remedies by the local authority to challenge conveyances into such trusts or other protection arrangements; and***
(4) ***explore the possible limits to legal privilege when a local authority seeks to show that a conveyancing transaction was entered into to avoid liability for social care costs.***

Before one even starts to consider such arrangements being entered into, does the creation of a family protection trust or similar represent appropriate or "best advice" to those clients who are seeking to protect an asset or assets where payment for future care might be an issue?

There is no consensus in this field as to how best to protect assets in the circumstances that can arise. What I can say is that subject to clients being given advice as to (i) whether such a trust is appropriate for their **overall circumstances** (and not just having regard to the care fees issue) and (ii) the potential limitations and disadvantages of such an arrangement, then in principle, I do not see that a client would be likely to be able to argue that they had not received appropriate advice having regard to either a potential complaint to the Scottish Legal Complaints Commission or in terms of the test for professional negligence in *Hunter v Hanley* 1955 SC 200.

On that understood footing it seems to me that advice in relation to a possible trust could represent appropriate advice for the purposes of protection of the interests of the client as well as limiting or in fact avoiding scope for future complaint by the client, or as sometimes happens, disappointed third parties, such as potential beneficiaries of an estate.

It follows that it seems to me that in the course of instruction in such a matter agents should be clear to record the scope of advice given and any qualifications or limitations to same and the information upon which that advice was tendered. I will touch on the possible issue of recovery of the file of the advising solicitor and what I say must have that possibility in view.

There are plainly broad issues to cover in seeking to ensure that the client is given proper advice and this must include them having advice as to whether a trust is appropriate for them (leaving aside the issue of possible protection from actions by the local authority). I will call this the "the First Issue".

In addition a client must have an awareness that a trust of any kind, including a discretionary trust, **is not a guarantee against recovery** as much depends on questions timing, capacity, foreseeability of need for care and whether there could be a proper basis for setting up a trust which does not point to it being a device to avoid fees. I will call this the "Second Issue".

The First Issue

Looking then at the First Issue , a transfer of property into trust might sometimes be seen as unduly complicated and perhaps not needed where for example the legal title may not have been vested in the appropriate person in the first place or may not reflect the present beneficial interest in the property.

A trust may not be appropriate and may in fact raise more questions if a trust is entered into when there is no apparent need to do so. A simple transfer of title might properly reflect who ought to benefit from the title to property as where the beneficial title has not been properly reflected in the legal title. Again any transfer should be done as soon as possible and when the transferor does not foresee the need for care. As always questions of timing and intention are important.

For example another person may have made substantial financial contributions to the property which should be reflected in the ownership -see for example *Nottingham City Council v Beresford and the Adjudicator to HM Land Registry,* 10 March 2011, and in a Scottish judicial review context *Cunningham v East Lothian Council* 2010 CSOH 185. In the latter case title to a council house was taken in joint names and it was found to be that the council had erred in law in failing to take into account the nature of joint ownership in assessing the value of the property for means purposes. Plainly title could be taken in a number of ways such as by joint title or subject to a destination.

Another issue that must be kept in view is, as in any transaction where there may be a transfer of property in which there is a continuing intention to reside, that the person in question should plainly receive independent advice and advice which can be seen to be independent. It is very important to clearly identify who the actual client is and then act solely in their best interests. This goes to what is "best advice."

There may of course be a degree of conflict of interest between a prospective donor and any donee or trust beneficiary where a substantial transfer or gift is contemplated whether that is done by outright transfer or trust. Any Law Society Guidance must be adhered to in that regard. It will make to easier to defend any future claims about advice being inappropriate. Agents of course must always be on the guard for any suggestion of undue influence or facility and circumvention lurking in the background.

In addition it is plainly a concern that an older person is more likely to lose their home to their family following a direct transfer than by means testing. In the latter case the state will not take the home. Rather the owner is disqualified for benefit or funding as a result of owning it. Whether a direct transfer is desirable (such as by lifetime gift to satisfy legal rights or otherwise) as opposed to a trust must, inevitably involve a degree of confidence in the benefitting family that they will allow the elderly person to continue to reside in the house until they die or can no longer do so. Families can fall out and circumstances can change. Such an informal arrangement plainly has risks.

In that situation a sale may be the best option but equally keeping it may or may not be a possibility. There are steps that can be taken to minimize that alternative risk. One might arrange a gift subject to a liferent and this of course ties the owner to that property. The downside of this is that any income subsequently derived from that settlement is means tested even if the capital is preserved.

As with any property matter there may be tax implications. A gift of property in which the donor continues to reside maybe unhelpful so far as CGT or IHT is concerned.

As regards CGT any owner occupier exemption would be lost as well as the tax free revaluation on death. As regards IHT the value of the property may still be included in the estate of the donor who continues to reside there under the reservation of benefit rules. Even if one arranged a gift subject to a tenancy this would still result in loss of tax benefits associated with home ownership and would create a tax liability on any rent paid.

Some of these consequences might be elided by a discretionary trust. However where tax affairs are simple and well within current IHT, tax concerns may be less of an issue. As always if tax is likely to be a consideration agents should either provide that advice or secure provision by a tax specialist.

It is important that any discretionary trust cannot be revoked. This means the truster must be made absolutely clear that they are aware of this. In that regard agents would need to consider whether a need on the part of the truster might arise in the future which could be defeated given this irrevocable quality.

A client needs to know the irrevocable nature of the act of putting assets into a discretionary trust and that because the trustees have unfettered discretion (subject to the usual limitations imposed by general trust law), there is no guarantee that the trustees will necessarily do what the truster would wish. It is for that reason that the truster should try to ensure that the trustees are competent and trustworthy people who are likely to act with the best interests of the truster in mind. Advice on the suitability of proposed trustees should form part of the package of what "best advice" is.

On the broader issue of what is appropriate in the sense of what is likely to work in terms of asset protection against the local authority, **essentially what matters are intention and the circumstances surrounding any transfer into a discretionary trust.**

An ordinary trust will not suffice as the beneficiary under such a trust has a right to the proceeds and even if he or she elects not to claim them, the local authority will take them into account as notional capital under the National Assistance (Assessment of Resources) Regulations 1992 (SI 1992/ 2977, Reg 25(1)). There is a good argument that the assets in a discretionary trust cannot be taken into account by the local authority in assessing what the granter when a resident in residential care can pay. This argument will be stronger if the disposal was done long before entry into care and where the circumstances do not suggest an intentional deprivation of capital in terms of care fee payment avoidance.

If ownership of the assets is passed from the resident as an individual to himself and others as trustees they cannot be claimed or taken into account by the authority if the disposal has been accomplished with a **demonstrably innocent intention,** for example the better management of an elderly granter's estate with a view to devoting its income when required to care fees. In such a case even with a disposal to a trust such an intention could be capable of being demonstrated notwithstanding the decision in *Yule v South Lanarkshire Council* 1998 SLT 490. It would be rather more difficult to do so following a disposal to a teenage granddaughter absent any real *ex facie* explanation for the transfer as occurred in *Yule.*

This was an Opinion from Lord Philip sitting in the Outer House. There, an elderly lady had given away her home to her family sixteen months before going into a care home. The local authority treated her as still owing the capital by applying regulation 25. She raised a judicial review and argued that the local authority could only go back six months. The argument for the local authority was that the six month rule found in sections 21 of the Health and Social Services and Social Security Adjudications Act 1983 was an additional anti-avoidance provision which did not restrict the charging provisions of section 22 of the 1948 Act and the 1992 regulations. It was not unlawful for the local authority to treat the value of the house as capital notionally held by her, even with the gap before admission to care.

Of course the problem for the lady in this case was that the evidence pointed to the deprivation being done in possible contemplation of a future need for residential care. This was the sequel to the first case-*Yule v South Lanarkshire Council (No2)* 1999 SCLR 985. There Lord Philip found that whether or not there was a deprivation of capital for the purpose of decreasing liability was a question of fact for the determination of the local authority.

He held that there was no need for the local authority to show that the person knew of the capital limits or had foreseen that an application for residential funding might be made. The local authority were entitled to conclude that the donation by *inter vivos* gift rather than by will, when taken with her age and worsening health, that the real motivation was avoidance of charges. This was appealed but without success-see *Yule v South Lanarkshire Council* 2000 SLT 1249.

The English courts have taken a similar approach to the regulations-see *R v Somerset County Council, ex p Harcombe* (1997) 37 BMLR 1. There Forbes J dismissed an application for judicial review. H sought judicial review of a decision by S to take into account the value of her home when calculating her contribution towards the cost of residential nursing accommodation. S had obtained a charge over H's house under the National Assistance Act 1948 sections 22 and 26, with enforcement suspended while her son lived there. Forbes J held, dismissing the application that under Part III of the Act those needing residential accommodation should pay for it if able to do so, rather than have it provided at public expense. The discretion conferred on local authorities by the National Assistance (Assessment of Resources) Regulations 1992 Sch.4 para.18 was expressed in general terms and the court should be slow to interfere with the exercise of such a wide discretion where it was clear that careful consideration had been given to all the relevant material circumstances.

Although the *Yule* "line" seems to give a rubber stamp to going back more than six months, in fact the timing of transfer of assets will remain of critical importance as if the assets were transferred a long time before the need for residential care services arises, the local authority will find it much more difficult to show that there was a prohibited purpose involved.

Even so it is for the authority to establish a positive case that there was a prohibited purpose. One issue is of course the "catch 22", that by taking professional advice a person is likely to gain knowledge about the regulations and care home charging and so potentially impact on a proposal for asset transfer even if the motive for transfer was something different e.g. tax planning.

If it is a dwelling house it will be particularly hard to argue that the transfer was for tax planning reasons given the reservation of benefit rules under IHT. Often such a person will continue to live in their home even if title has been transferred to their children. There will often be no real tax benefit and so it would be hard to argue that this was the motive as opposed to the avoidance of care charges.

The evidence of intention is important. If no intention be demonstrated on a transfer even weeks before going into care, that could be defended although that would be unusual. A sudden illness which was not foreseen in advance of the transfer might be an example. Conversely transfers which took place years before cannot escape being treated as notional capital if there is clear evidence of an intention to avoid at the time.

All that being said and subject to the advice being "appropriate" in the sense I have described, notwithstanding this it is usually advantageous to transfer assets as long as possible before the entry to care. It is plainly the case that care should be taken not to say anything about avoiding the residential care costs.

However it is important to realize that a discretionary trust it is not in itself provide a bright line protection from the local authority's powers. As always timing, evidence of intention and trust purposes have to be borne in mind.

It is important that any such trust cannot be revoked. I have touched on the possible implications surrounding this.

I would stress that it is the date of the actual transfer of the assets to the trust which counts for assessment purposes not the date the trust is set up. The six months' time limit in Section 21 of the 1983 Act still applies even when the transfer of assets has been to a trust rather than to an actual person. It follows that a transfer into a trust within six months of going into a care home is capable of challenge under section 21. If the local authority uses bankruptcy remedies the period can be longer.

It follows that is a trust is to be used then in general terms transfers of assets into it should be done at the earliest possible opportunity and in circumstances where it is open to proof, directly or by inference, that there were reasons for the transfer which do not point to an avoidance strategy.

If the transfer of the assets to the trust takes place within the six months period or after the entry to care, then the local authority can claim them back or their value back from the trust just as they could from any other party who received them from the resident at less than market value.

Per *Yule*, furthermore the local authority may also treat the transfer of assets into a trust as notional capital without limitation of time, provided it could reasonably infer that the purpose was avoidance. While that will not generate actual payment of fees by the resident, it will establish *prima facie* liability to do so, albeit as I will come on to, actual liability will need to be established via ordinary civil debt recovery.

If the transfer takes place more than six months prior to the entry to care and there is evidence of an avoidance intention the value of the transfer assets cannot be reclaimed by the authority but they will be treated as notional capital. The actual assets could however be reclaimed in insolvency proceedings.

How does one assist in showing appropriate intention?

Examples which can sometimes be used to bolster the contention that the transfer was not done with the primary purpose of defeating care costs was where someone may have provided care services over many years in reliance upon assurances that the property would continue to be available for occupation after the death of the present owner – see for example *Re Kumar (a bankrupt)* [1993] 2All ER 700; *Ellis v Chief Adjudication Officer* [1998] 1 FLR 184. Provided that such an arrangement could be evidenced and was not seen to be device (e.g. that care was provided and was evidenced in terms of what was done and the hours involved and where the care recipient demonstrated an intention that the carer be provided for, that could be capable of showing this intention. In the context of a discretionary trust, the trustees could exercise discretion to pay such a person as and when appropriate during the lifetime of the truster.

In these situations it may be desirable to give effect to a transfer where the older owner can still make a decision so as to establish legal rights which they wish to have acknowledged.

In other cases the gift may simply be thought of as a means of preserving property for the next generation with a general assurance as to future use and occupation and in some cases as to the provision of personal care if needed.

One other argument to bolster the use of a discretionary trust is that because the trustees have sole discretion the choice of such a trust as a destination for assets is that it provides protection against irrationality and mistakes of old age and mistakes and misfortunes. If that is indeed what motivates the trust then that might be something that ought to be recorded as relevant to the intention of the truster-again this is where a Letter of Wishes may be useful. I mention that later.

This is the sort of situation that might arise and this could reflect the situation reflected in a discretionary trust deed in terms of making provision for the management of income and liabilities.

Are such arrangements likely to successfully protect an asset in the event of challenge by a local authority?

This really touches on the Second Issue I have identified in relation to *"best advice"*, in my view what can be said is that every case depends on the circumstances, notably issues of intention and timing of any transfer. A trust, given the particular circumstances of transfer is capable of protecting assets. Whether it in fact does so is fact sensitive as I shall hope to illustrate. Furthermore to some extent the issue of challenge by the local authority will also depend on the appetite of the authority for taking action via debt recovery and if the political or moral appetite exists, whether it would be prepared to seek to challenge a trust by way of remedies under bankruptcy law.

On the first point in terms of recent case law, *Argyll & Bute Council v Gordon* from the Sheriff Appeal Court and reported at 2017 SAC (Civ) 6 has established that a local authority cannot simply make its own assessment of liability and then seek to recover it. It must pursue an action of debt in the ordinary way and seek to prove that the debt is due. The court would have to decide whether the local authority is in fact a creditor in respect of care costs. Once decree for care costs has been secured the authority would need to use diligence in the usual way to recover sums due.

This case appears to have established that it is not open to the local authority to simply determine liability for itself and then seek payment for it without, if resisted, recourse to ordinary civil debt recovery procedure. To that extent current law requires the authority to obtain a court decree to secure payment of an alleged debt.

It would also seem to follow from this, that if a debt is secured by a decree but satisfaction of the same through diligence suggests that assets have been transferred, then the authority would need to take a view on whether it then wishes to enforce that decree by means up to and including sequestration proceedings.

There is some suggestion that under English procedure, that it is arguable that a finding of an avoidance purpose is sufficient for the resident's former home to be treated as notional capital to justify setting aside a transfer at a single hearing which could result in a gift of property being set aside or the done or donees being obliged to pay home care fees up to the value of the property - see *Derbyshire County Council v. Akrill* [2005] EWCA Civ 308. However I am not sure this would be the Scottish approach. It seems more likely that in Scotland one would need to secure a decree for the underlying debt and if that could not be enforced then look at further proceedings to challenge any disposal of property. It follows there could be a series of proceedings and that may not be realistic for some local authorities, albeit there is no legal bar as such.

I have been unable to find an example of where such a trust arrangement has been considered in the context of a challenge to recovery of care home fees. That does not of course suggest any particular view should be taken as to the robustness of such an arrangement because at the same time there is my view a growing potential for local authorities to use bankruptcy remedies as a way of challenging property transactions outwith the scope of the remedies open to them under the 1992 Regulations (that is by way of assessment of notional capital) or under the Health and Social Services and Social Security Adjudications Act 1983, section 21.

Bankruptcy remedies could be pursued by way of the Bankruptcy (Scotland) Act 2016 or at common law in relation to unfair preferences as regards creditors or transactions under value. The utility of such a bankruptcy based approach from local authority perspective is that the time limits of challenge are rather more generous than respective challenges brought under the section 21 of the 1983 Act or by assessment of notional capital under the Regulations.

The point to bear in mind is that transfer into **any form of settlement, including a discretionary trust,** is potentially vulnerable to the local authority's enforcement powers. The existence of the settlement and the issue of intention behind the reason for the transfer of the property are crucial. If it is seen as a deliberate deprivation the transfer will fail to achieve its objective.

The most important issue in all of this is whether any gift of a home would have the desired result. To some extent this is a matter for speculation rather than concrete legal advice because much depends on the attitude of any given local authority and whether they are prepared to exercise a full range of legal remedies open to them and by that I mean remedies under bankruptcy law.

Over the course local authorities have not always had the appetite for pursuit of such remedies that might be open to them but there are indications of a growing appetite in some authorities to do so.

Third parties may of course be liable sums due towards the cost of residential care. These may be recovered by a local authority where residents disposed of assessable assets by way of a gift or undervalue disposal to a third party within six months before admission to residential accommodation or whilst in that accommodation, **knowingly** with the intention of avoiding charges for the accommodation.

This is in terms of Section 21 of the 1983 Act. The third party, typically a family member, will become liable to pay a contribution towards assessed care fees but only to the amount which they have received. This could apply to transfers into a discretionary trust in that six month period. The trust would be liable and probably if the trustees had transferred any asset so transferred to a beneficiary, the beneficiary in turn.

Further in terms of enforcement a resident may be treated as possessing an asset of which they have deprived themselves at any time for the purpose of avoiding or decreasing the amount they are financially assessed to pay. This is the concept of notional capital under the 1992 Regulations. I would observe that notional capital is deemed to reduce as it is treated as being spent on fees and notional income ceases to be taken account when it would cease to be made available anyway.

Following upon *Yule*, there is no time limit on the disposal in relation to assessment of notional capital but clearly the longer it is since a gift was made the more difficult it would be for the authority to establish the purpose was to avoid financial assessment and so bring into account the notional capital provisions. In particular it is likely to be unreasonable for an authority to treat the transfer as deliberate deprivation when the disposal took place at a time when the resident was fit and healthy and could not have foreseen the need for move them to such accommodation. This is the tenor of the current Guidance from Scottish Government, *"Charging for Residential Accommodation Guidance"*. The authority would need to show foreseeability or immediacy of the need for care. It follows that an asset given away before residential care was contemplated is unlikely to be caught by this, whereas any gift made immediately before or after admission is vulnerable **even if a further purpose can be established**.

It may be necessary for the authority to establish the resident knew of the means testing implications before making the transfer otherwise there could not be an intention to avoid them. However it is the subjective intention of the resident that matters, not what others might (objectively) consider to be the case-see *R(Beeson) v. Dorset County Council* [2001] EWHC 986. That is why background as to why a trust was set up is likely to be useful material in establishing subjective intention.

Some local authorities may be prepared to use bankruptcy in order to recover the value of assets given away. This could arise where the resident is sued for care costs, decree obtained then made bankrupt whereupon transactions that can be seen as undervalue or unfair preferences as between creditors may be set aside. This is subject to the time limits of the Bankruptcy (Scotland) Act 2016. The advantage to an authority is that some of these time limits (see section 98 on gratuitous alienations) are rather more generous than the six month rule in section 21 of the 1983 Act. They can go back further and potentially could recover the whole debt owed.

To do this the authority would need to get a judgment against a resident for unpaid contributions and then make the resident bankrupt and then challenge any gift, including a transfer into a discretionary trust in other proceedings. In other words there may be a need for at least three sets of proceedings.

The provisions of bankruptcy law are broad and the court can make a range of orders to restore the position as to what had been had the transaction not taken place. It is probably sufficient if the purpose was to put the asset beyond the reach of a person who might at some time make a claim or otherwise prejudice the interests of such a person – see *Midland Bank Plc v Wyatt* [1995] 1 FLR 696.

This does not have to be the sole purpose and it may be sufficient for it to be a substantial rather than a dominant purpose. However the mere fact that the transaction was made without consideration does not of itself establish that it was made to defeat creditors as result cannot be equated with purpose.

In this context of ignorance of the deprivation rules could be helpful even if the entry to care took place within six months of the transfer and he or she had other good reasons for setting up the trust and the transfer of assets. This is because the Section 21 of the 1983 Act requires the transfer to be done *"knowingly".* Note though in relation to unfair preference in bankruptcy law, the question of intention is not necessary as this is brought by way of a statutory challenge without reference to the purpose behind the transfer.

In relation to bankruptcy it is always open to a local authority to argue that disposal to relatives via a trust is a disposal which might be caught by bankruptcy law. Those entering into a trust must be advised that this is always a possibility albeit there are time limits that that the authority needs to show and also defences which could often apply. This has to be an aspect of "best advice." Agents should explain that a trust is not a guarantee against recovery under bankruptcy law although, for reasons which I hope will be apparent, there may be practical and legal limitations to such remedies.

Under the Bankruptcy (Scotland) Act 2016 gratuitous alienations are covered by section 98 and unfair preferences in section 99. These provisions were in force from 30 November 2016. Section 98(1)(a) makes the provision retrospective. I have highlighted in bold points of interest.

98 Gratuitous alienations

(1) Subsection (2) applies where—

(a) by an alienation (whether before or after the coming into force of this Act) by a debtor—

(i) any of the debtor's property has been transferred, *or*

(ii) any claim or right of the debtor has been discharged or renounced,

(b) any of the following has occurred—

(i) the debtor's estate has been sequestrated (other than, in the case of an individual, after the debtor has died),

(ii) the debtor has granted a trust deed which has become a protected trust deed,

(iii) the debtor has died and within 12 months after the date of death the debtor's estate has been sequestrated, or

(iv) the debtor has died, the debtor's estate was absolutely insolvent at the date of death and within those 12 months a judicial factor has been appointed under section 11A of the 1889 Act (see section 107) to administer that estate, and

(c) the alienation took place on a relevant day.

(2) The alienation is challengeable by—

(a) any creditor who is a creditor by virtue of a debt incurred on or before (as the case may be) the date of sequestration, the granting of the trust deed or the debtor's death, or

(b) (as the case may be) the trustee in the sequestration, the trustee acting under the trust deed or the judicial factor.

(3) For the purposes of paragraph (c) of subsection (1), the day on which an alienation takes place is the day on which the alienation becomes completely effectual.

(4) In that paragraph, "relevant day" means, if the alienation has the effect of favouring—

(a) a person who is an associate of the debtor, a day not earlier than 5 years before, or

(b) any other person, a day not earlier than 2 years before,

(as the case may be) the date of sequestration, the granting of the trust deed or the date of death.

(5) On a challenge being brought under subsection (2), the court must grant decree—

(a) of reduction, or

(b) for such restoration of property to the debtor's estate, or such other redress, as may be appropriate.

(6) Except that the court is not to grant such decree if the person seeking to uphold the alienation establishes—

(a) that immediately, or at any other time, after the alienation the debtor's assets were greater than the debtor's liabilities,

(b) that the alienation was made for adequate consideration, or

(c) that the alienation was—

(i) a birthday, Christmas or other conventional gift, or

(ii) a gift made, for a charitable purpose, to a person who is not an associate of the debtor,

being a gift which, having regard to all the circumstances, it was reasonable for the debtor to make.

(7) Subsection (6) is without prejudice to any right acquired, in good faith and for value, from or through the transferee in the alienation.

(8) In subsection (6)(c)(ii), "charitable purpose" means any charitable, benevolent or philanthropic purpose whether or not it is charitable within the meaning of any rule of law.

(9) For the purposes of subsections (1) to (8), an alienation in implementation of a prior obligation is deemed to be one for which there was no consideration, or no adequate consideration, to the extent that the prior obligation was undertaken for no consideration, or no adequate consideration.

(10) This section is without prejudice to the operation of section 2 of the Married Women's Policies of Assurance (Scotland) Act 1880 (which provides that a policy of assurance may be effected in trust for spouse, future spouse and children) including the operation of that section as applied by section 132 of the Civil Partnership Act 2004.

(11) A trustee in a sequestration, a trustee acting under a protected trust deed or a judicial factor appointed under section 11A of the 1889 Act has the same right as a creditor has under any rule of law to challenge an alienation of a debtor made for no consideration or for no adequate consideration."

In that regard it should be borne in mind that there is a defence to a disposal by a bankrupt in the five years (to an associate-typically a family member-trustee or beneficiary), prior to the commencement of bankruptcy proceedings. That cannot be cut down if at the time and after the disposal the bankrupt is solvent.

Many ordinary elderly people who give away their houses and other assets to relatives in their trust will not become insolvent in so doing. They will continue to have some income such as retirement, pension or other provision, whether state or private and probably will never be in a position not being able to pay for their daily needs as they arise. It is helpful if a record of the financial position in terms of income and liabilities is kept to establish solvency.

Accordingly in an average case of a pensioner of modest lifestyle and whose main debts are gone eg mortgage, car loans and the like, one may often be able to rely on the section 99(6) defence. It is the case that they may well be solvent for most of the period between disposal and being allowed entry into residential care.

The provisions in the Bankruptcy (Scotland) Act 2016 say nothing explicitly about **prospective liabilities** (such as possible future care costs). It is arguable it is about historic existing debt and not possible future debt. In any event it could be argued that that solvency intervening between the transactions by which the assets were disposed of and the date of sequestration prevents the transactions from being cut down.

Section 99 provides-

99 Unfair preferences

(1) Subsection (5) applies to a transaction entered into (whether before or after the coming into force of this Act) by a debtor which has the effect of creating a preference in favour of a creditor to the prejudice of the general body of creditors, being a preference created not earlier than 6 months before—

(a) the date of sequestration of the debtor's estate (if, in the case of an individual, a date within the debtor's lifetime),

(b) the granting by the debtor of a trust deed which has become a protected trust deed,

(c) the debtor's death where, within 12 months after the date of death—

(i) the debtor's estate is sequestrated,

(ii) a judicial factor is appointed under section 11A of the 1889 Act to administer the debtor's estate and that estate was absolutely insolvent at the date of death.

(2) But subsection (5) does not apply to—

(a) a transaction in the ordinary course of trade or business,

(b) a payment in cash for a debt which when it was paid had become payable,

(c) a transaction by which the parties undertake reciprocal obligations (whether the performance by the parties of their respective obligations is to occur at the same time or at different times),

(d) the granting of a mandate by a debtor authorising an arrestee to pay over the arrested funds, or part of the arrested funds, to the arrester where—

(i) there has been a decree for payment or a warrant for summary diligence, and

(ii) the decree or warrant has been preceded by an arrestment on the dependence of the action or followed by an arrestment in execution.

(3) Paragraphs (b) and (c) of subsection (2) are to be disregarded if the transaction in question was collusive with the purpose of prejudicing the general body of creditors.

(4) For the purposes of subsection (1), the day on which a preference is created is the day on which it becomes completely effectual.

(5) The transaction is challengeable by—

(a) any creditor who is a creditor by virtue of a debt incurred on or before (as the case may be) the date of sequestration, the granting of the protected trust deed or the debtor's death, or

(b) (as the case may be) the trustee in the sequestration, the trustee acting under the protected trust deed or the judicial factor.

(6) On a challenge being brought under subsection (5) the court, if satisfied that the transaction challenged is a transaction to which that subsection applies, must grant decree—

(a) of reduction, or

(b) for such restoration of property to the debtor's estate, or such other redress, as may be appropriate.

(7) Subsection (6) is without prejudice to any right acquired, in good faith and for value, from or through the creditor in whose favour the preference was created.

(8) A trustee in a sequestration, a trustee acting under a protected trust deed or a judicial factor appointed under section 11A of the 1889 Act has the same right as a creditor has under any rule of law to challenge a preference created by a debtor."

Under the statutory provisions in section 99, it is necessary for the challenger to prove only the transaction took place less than six months before the date of sequestration. It would be necessary for the council to show the debtor was absolutely insolvent at the time of the transactions or as a consequence of it and was also absolutely insolvent at the time of the challenge.

The latter situation might be unlikely where an elderly person has made a prudent and carefully considered transfer of assets. It would also not apply where the transfers were more than six months

One also must be alive to the **common law concept of fraudulent preference** where someone already insolvent engages in transactions designed to benefit one or more creditors.

One other argument is that there can be no element of undervalue or gratuitous where the assets of a person who has received care at a home are transferred to the person who had provided it, the argument here is that the person might be regarded as receiving whole or part recompense for services rendered. This is really a point from the *Kumar* case and the authorities discussed therein. If that argument were to succeed it would be applicable only to cases where the assets had been transferred to a person who provided care.

It would not normally succeed where assets had been transferred to some other person to a trust but a transfer to a trust could possibly work to allow for the carer to be recompensed is the sole beneficiary of the trust and the trust purpose as stated as being to recompense X for caring services rendered.

In that regard there would be nothing to stop parties drawing up an informal record of the care provided and hours expended on care. This may touch on some of the points arising from the Letter of Wishes I note below.

Wording of the Trust

One of the issues here is that a client who has had advice would not be able to plead ignorance of the rules on means testing. Such a client would have been told about the deprivation rules and intention and therefore could not plead ignorance.

However this is also subject to the important point that this could well be read as part of comprehensive advice which could fall within the band of appropriate considerations raised by a legal adviser and where there are plausible destinations for the assets. Raising the issue of the local authority taking action later because of a possible concern over care costs, does not mean that is evidence of that being the intention behind a transfer. It is capable of being seen as part of a wider package of advice to a client on the potential implications of a transfer.

So for example where there are young children as beneficiaries of the trust, a range of reasons innocent as well as incriminating, could arise such as for making educational or similar provision for the children or grandchildren (the latter is perhaps more likely).

Another reason for the transfer, for example, could be for the better management of the property or to protect successors or creditors.

Some deeds refer to better management of affairs in relation to the *"maintenance and repair of my residence and for the care of the after mentioned beneficiaries….".* These might be regarded as the trust objects rather than the purposes, being the beneficiaries under the trust (the occupant of the residence and the care of others). Every trust must have an object in relation to who the trust can be enforced. Often a beneficiary is also the truster as well as the defined family members.

In my view thought might be given to a Letter of Wishes as to how trustee powers ought to be used as opposed to the sort of preamble approach mentioned in the preceding paragraph. That could help further reflect the background to the setting up of the trust without any narration in the preamble.

Indeed such a narration may be (i) unnecessary as being superfluous see *Drafting Trusts and Will Trusts in Scotland: A Modern Approach* at 9.16 to 9.17) and (ii) perhaps be seen as contrived in the sense of the truster by making special mention of their residence might be seen as making that issue one of particular prominence. Why should putting a house into trust make for (impliedly) better care and maintenance than not so doing? I note that may trust deeds in any event deal with repair and management of property as a power of the trustees. There is no need to give it as a purpose.

It can also be maintained that trust purposes are not necessary where the disposal of the estate is left to the discretion of the trustees-see *Angus's Exrx v. Batchan's Trs* 1949 SC 335. Such stated purposes arguably conflict with the nature of pure discretion.

Arguably it is enough to simply use general trust purposes without a preamble stating what the overall general purposes are. That is why some use a Letter of Wishes to give some direction to discretionary trustees which is not hampered by possible limitations imposed by a superfluous preamble.

On the wording of a deed, in this vein it is probably superfluous to state, for example, that the truster wishes to make *"better provision for the maintenance and repair of my residence and for the care of the after mentioned beneficiaries, namely me, the said …..etc."* These purposes are really stated or otherwise implied by law (maintenance of the trust estate).

Arguably by stating that a "purpose" *could be* the maintenance of the residence of the truster, that draws attention to the residence as having a special status within the trust. If not singled out for particular mention that might deflect future inquiry.

That being said there is a practice of sometimes having a truster draft a non-binding Letter of Wishes to give direction to the trustees as to how powers ought to be exercised. It is best that this is separate from the body of the trust deed itself. It could reflect some of the points made in the preceding paragraphs, for example a desire to ensure that debts are taken care of, good investment decisions are made as the granter gets older, or that children or others benefit from the prudent management and maintenance of the trust estate. Where some family members have provided care for the truster, mention of this in a Letter of Wishes might also assist in structuring how discretion ought to be exercised.

It should not be expressed in imperative terms as that could over-ride the trust-see *Chen v. Ling* [2000] HKCFI 481 and 552 and also [2006] TLI 262; *Drafting Trusts and Will Trusts in Scotland: A Modern Approach* and *Trust, Trustees and Executors* at 6.15 to 6.16.

The terms can be strong but cannot be binding-so for example “strong desire” is sometimes used. Reasons for any expressed wishes should be given if they are not obvious. It should be signed and dated and a witness is preferable. Best practice is for trustees to check if the wishes remain the same by way of periodical review with the truster.

The advantage of such a “Letter of Wishes” is that it is non-binding and cannot be regarded as mandating any outcome. It can be updated. It can state things in it that would be difficult to state in a trust deed itself. It could for example reflect the wishes of the truster as to how funds are to be invested or managed or what repairs or management of the residence they would wish to be done.

Are there any current legal challenges in terms of case law pending in respect of family protection trust arrangements?

Right now I am not so aware. However any challenges would almost certainly have to involve the consideration of intention behind the transfer. One is unlikely to secure a court decision which declares that a trust is always, in all circumstances, immune from challenge. A trust is potentially useful but if one gets into the use of the remedies available under the 1992 Regulations or section 21 of the 1983 Act or the potentially wider remedies under bankruptcy law then cases will almost certainly turn on their own facts.

Equally, from a local authority perspective the use of a trust and the subsequent need to use, if potentially fruitful, bankruptcy remedies with the potential for a series of litigations following upon the approach in the *Argyll and Bute Council* case, to undo the trust, might be both in cost/ benefit terms expensive and therefore unattractive. Such an approach might prove politically unpopular depending on the authority in question. However these are not per se bars in law to recovery action.

Legal Professional Privilege and Recovery Action

An important consideration is the recovery of the instructed solicitors file. The recovery of the file of the solicitor related to any transfer may reveal the true nature of dominant purpose of the gift or other transaction at undervalue. The solicitor who dealt with the transfer will know the true purpose if they gave advice before it was made.

Ordinarily such files would be covered by legal professional privilege but there are some indications in the case law that the file may be recoverable if there is *prima facie* proof of fraud see for example *Barclays Bank Plc v Eustice* [1995] 4 All ER 511.

If the court considers, always balancing the need for clients to speak frankly to their legal advisers (which could include *bona fide* inquiry and advice about the possible implications of a transfer and possible scope for local authority challenge, even if not done with avoidance in mind), it could come to the view that the purpose of the transaction may have been to avoid means testing, the court could order disclosure of the solicitors file to ascertain whether this really was the case. See for example Schiemann LJ in the *Barclays Bank plc* case.

More recently in the specific context of care home fees recovery of the file was ordered in *Brent LBC v Kane* [2014] EWHC 4564 (Ch); [2015] B.P.I.R. 576. There a Temporary High Court Judge held that it was appropriate to order the disclosure of legal advice given in connection with various transactions alleged to have been made at an undervalue, even though such advice would ordinarily have attracted legal professional privilege, because the evidence supported a *prima facie* case that the transactions had been carried out for iniquitous purposes. For further discussion of the case see for example Co. L.J. 2015, 60(Mar/Apr), 5 ; Eld. L.J. 2015, 5(2), 190-196 and P.C.A. 2015, 20(4), 20-21.

In terms of the factual background, there the applicant local authority applied for an order requiring the second and third respondents (K) to disclose documents relating to transactions it alleged had been made at an undervalue.

The first respondent (D), who was K's late father, had owned a property jointly with his wife (M). At the date of her death, sums were owed to the local authority in respect of residential care. The local authority also provided residential care to D from 2007 until his death in 2013, but since 2009 had received no payment for that care. In 2007, D had granted K enduring powers of attorney. Thereafter, K effected a transfer of 25 per cent of D's property to each of them. K also purported to grant two mortgages over the property. The property was later sold.

The local authority brought proceedings against D's estate and K, alleging that the transfer of 50 per cent of the property to K, the purported grant of the mortgages to K, and the sale of the property, were all transactions carried out for the purpose of avoiding payment for the residential care provided to D.

Pursuant to the iniquity principle of English law, the local authority sought the disclosure of all information and/or documents which D and K had a right to inspect, **including legal advice**, which was held by K's solicitors or any other person who had assisted K, and which pertained to or was material to (i) the drawing and execution of the powers of attorney granted to K; (ii) the administration of M's estate; (iii) the purported mortgages granted to K; (iv) the transfer of the property to K; (v) the sale of the property.

K argued that there should be no disclosure as the documents sought were clearly privileged and the rule relating to privilege covering legal advice was absolute. They submitted that the *Barclays Bank plc* case which had discussed the principle of iniquity, was not good law, and that even if it was good law, there was no prima facie evidence that the transactions had been entered into for iniquitous purposes.

The Judge held that it was clear that there were exceptions to the general rule that communications between a solicitor and client attracted legal professional privilege. The iniquity principle was a well-recognised exception.

The evidence demonstrated that there was a prima facie case that there had been transactions at an undervalue which were designed to prejudice the local authority's interests and put assets beyond its reach. **Of note, all of the transactions had been made at a time when D lacked capacity to make decisions for himself**, namely after the powers of attorney were granted.

They had also been made at a time when K knew that it was likely that D might need to go into residential care, and in circumstances in which they were aware, from the fact that M had also been in residential care, that the amount that D would be charged for such care would depend on his financial situation.

Further, M's will had been dealt with in an extraordinary way, bypassing the probate process, the payment of debts, and the requirements of Revenue and Customs.

There was also no evidence of K making large loans to D, as they alleged, or of any agreement that any such loans would be secured against the property. No explanation for the purported mortgages had been advanced. In those circumstances, the evidence supported a prima facie case of sharp practice or something underhand, making it appropriate to order disclosure of the relevant documents.

Of course from what is noted in bold there are a range of considerations which assisted recovery. There was on the face of it not good explanation for some of the transactions. A trust as proposed by agents might bear to show purposes which are about better management of assets and affairs.

A Letter of Wishes which is realistic in its terms in the circumstances and not apparently contrived could assist. As noted simply raising the possibility of future local authority action is not in itself evidence of an improper motivation at a time when it is not foreseeable that care might be needed. File notes reflecting advice given may in fact assist in that regard.

If one could show in fact that acts had been taken under the trust which were real in effect, that could assist in resisting recovery. Likewise where as a whole matters, appear regular (as opposed to here where there were, for example, issues over dealings with HMRC), that could assist.

Of clear importance was that transactions had been when (i) it was likely that residential care might be needed and (ii) the donor lacked capacity when the disposal under the powers of attorney were made. Again all of this suggests that the earlier the disposal is done and where the donor has capacity, may well be capable of being of assisting in resisting an application for recovery showing a lack

There is no recent Scottish authority on this issue but what authority there is, is from the Court of Session and I would suggest that a similar outcome might obtain in a Scottish case.

In *Micosta S.A. v. Shetland Islands Council* 1983 SLT 483 at 485, the First Division noted that on a review of authority, legal professional privilege might be lost where fraud or some other illegal act was alleged against a party and his law agent has been directly concerned in the carrying out of the very transaction which is the subject matter of the inquiry. Of note the solicitor need not be personally implicated in the fraud or illegality. The wrong need not be criminal-see *McCowan v Wright* (1852) 15D. 229.

It is also the case that there needs to be direct involvement of the solicitor in the carrying out of the act. The provision of just advice is not enough to justify recovery. However as typically agents will provide both advice and conveyancing that is perhaps an unlikely scenario.

It should be borne in mind that recovery of a file could be sought pre-litigation by way of an application to the Sheriff or Court of Session under s. 1 of the Administration of Justice (Scotland) Act 1972. To date I am unaware of such a step having been taken.

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