Hastings-Bass in Jersey: Setting Aside Trustee Decisions to Help Beneficiaries

Introduction

There have been four recent Jersey cases which have helped to develop and clarify the law applicable to situations where trustees exercise a discretion which is later found to have had adverse and unintended consequences, and where the trustees would have acted differently had they taken relevant factors into account, or had they not taken irrelevant factors into account. These cases are as follows:

- *The Representation of Seaton Trustees Limited [2009] JRC 050*;
- *The Representation of Vistra Trust Company (Jersey) Limited [2008] JRC 111*;
- *The Representation of Leumi Overseas Trust Corporation Limited [2007] JRC 248*; and
- *The Representation of Seaton Trustees Limited [2007] JRC 206*.

These cases all show that where trustees do something they would not have done, or omit to do something that they would have done, had they or their advisers had full information, the court may set aside the act (or omission) in order to prevent the adverse effect. Examples of such adverse effects have included the incurring of an unexpected liability to tax, including non-Jersey tax. The principle engaged in these circumstances is known as the Hastings-Bass principle and provides a helpful remedy which may well prevent hostile litigation for breach of trust or negligence and the costs and risks associated with such litigation.

The Hastings-Bass principle derived from *Hastings-Bass v. Inland Revenue Commissioners [1975] 1 Ch 25.* In that case an appointment had been made to a sub trust which in part infringed the rule against perpetuities and was therefore void to that extent. The court nevertheless allowed the part that did not infringe the rule to be effective on the basis that the trustees had not failed to ask themselves the right questions or to arrive in good faith at a reasonable conclusion. A series of cases drew upon that reasoning so that the Hastings-Bass principle could later be formulated in *Sieff and Others v. Fox and Others [2005] 1WLR 3811* as being "*where trustees act under a discretion given to them by the terms of the trust, in circumstances in which they are free to decide whether or not to exercise that discretion, but the effect of the exercise is different from that which they intended, the court will interfere with their action if it is clear that they would not have acted as they did had they not failed to take into account considerations which they ought not to have taken into account, or taken into account considerations which they ought not to have taken into account*".

This could be summarised by saying it applies where the trustees have made a mistake. However, to do so is an oversimplification and does not take account of the limitations set out above nor does it coincide with the legal definition of what constitutes mistake for the purposes of rescinding a transaction.

The legal principle of mistake is that, "*wherever there is a voluntary transaction by which one party intends to confer a bounty on another, the deed will be set aside if the court is satisfied that the disponer did not intend the transaction to have the effect which it did. It will be set aside for mistake whether the mistake is a mistake of law or of fact, so long as the mistake is to the effect of the transaction itself and not merely as to its consequences or the advantages to be gained by entering into it*" (*Gibbon v. Mitchell [1990] 1WLR 1304*). Accordingly, although Hastings-Bass may involve a mistake it should not be confused with mistake giving rise to the legal remedy of rescission.

The four recent cases

Bedell Cristin acted for the trustees in all four successful applications, each of which sought to set aside transactions which had unintended adverse tax consequences.

In the Representation of Seaton Trustees Limited of 2007, Mr Morgan (an English domiciled investment banker resident in Russia for UK tax purposes) wished to establish a Jersey trust, to which he would assign employee compensation benefits to which he was entitled under an agreement subject to Isle of Man law and which would mature on a sale of the business. Tax advice was taken from UK tax accountants both for Mr Morgan and for the proposed Jersey trustee, in relation to the tax consequences of the assignments. The advice covered income tax but failed to cover the inheritance tax impact of the transfers. A discretionary Jersey law trust was duly created with a Jersey trustee and the rights to the benefits were assigned and novated to the trust by agreements subject to Isle of Man law. Six months or so later the settlor was informed of the unanticipated inheritance tax liability arising from the assignments to the trust. Mr Morgan was immediately and primarily liable and the trustees had a secondary liability. Mr Morgan was less than happy. The trustee successfully applied to set aside the novation and assignment agreements and obtained an order that the compensation benefits were held by them on a bare trust for Mr Morgan thus extinguishing the inheritance tax liability.

In the Representation of Leumi Overseas Trust Corporation Limited, trustees wished to make investments in a Guernsey protected cell company, the object of which was to enable investments to be realised without the immediate UK capital gains tax liability which might otherwise apply. The trustees sought UK tax advice in February 2000 on how to structure the investments. The trust owned an underlying company which held the necessary funds to make the investments. The accountants advised that the investments should be made by the trust, not by the underlying company. In reliance on the advice in June and August 2000, the underlying company lent sufficient funds to the trust to enable it to make the investments. However, it was only in July that the UK Finance Act 2000 was passed. This amended the Taxation of Chargeable Gains Act 1992 and dramatically affected the capital gains tax implications of applicable transactions entered into with effect from and after the date of the March 2000 budget day, including the two investments in June and August. The liability would not have arisen if the investments had been made direct by the underlying company, rather than by the trust. The trustees successfully applied to set aside the loans from the underlying company and obtained a declaration that the investments were held by the trustees on a bare trust for the underlying company thus extinguishing the tax liability.

In the Representation of Vistra Trust Company (Jersey) Limited, previous trustees had converted an interest in possession trust into a discretionary trust. It subsequently became apparent that the variation caused an immediate transfer of value of the settled property and therefore gave rise to a significant inheritance tax liability on the life tenant. This was a matter on which the previous trustees had taken no advice as to the tax consequences (as opposed to a matter on which incorrect tax advice had been taken). The successor trustee succeeded in setting aside the deed of variation in question.

In the Representation of Seaton Trustees Limited of 2009, the trustee had withdrawn funds from a bond comprising 100 life policies with Canada Life International in the Isle of Man. The trustee's agent had understood the nature of the transaction (a withdrawal of funds) but had misunderstood the income tax effect of the transaction on the settlor, which was dramatically different depending on the mode of withdrawal (a partial withdrawal from each segment as opposed to a surrender of a number of whole segments). Given the scale of the withdrawal, the former method had significantly worse tax consequences than the latter. The trustee applied to set aside the withdrawals so that they could be replaced by surrenders of sufficient segments to extract funds of the same value.

What is the current test for granting Hastings-Bass?

The principle and its development under English law is fully described in the decision of *Sieff v. Fox.* Essentially, there are four limbs to the test:

1. the trustees must be acting under a discretion given to them under the terms of the trust;

2. the effect of the exercise of discretion is different from that which the trustees intended;

3. the trustees have failed, in that they have taken into account irrelevant considerations or have failed to take into account relevant ones; and

4. they would not have acted as they did but for the failure.

This principle was first applied in Jersey in *In the matter of Green GLG Trust [2002] JLR 571.* It was re-affirmed and further developed in the four recent cases noted above.

In these cases, the following eight questions were considered:

- Is fault required on the part of the trustees and/or their advisers?
- The trustees *would* or *might* have acted differently. What is the appropriate test?
- Where foreign agreements are set aside, which law governs the Hastings-Bass application?
- Can Hastings-Bass relief apply to set aside transactions between trustees and third parties?
- Can Hastings-Bass relief apply to set aside a transaction where subsequent agreements affecting the subject-matter of the first have been concluded?
- Is the transaction void or voidable?
- Does Hastings-Bass relief apply to administrative decisions as well as dispositive ones?
- What is the position of HM Revenue and Customs ("HMRC")?

Is fault required on the part of the trustees and/or their advisers?

The court said "no". Following the judgment in *The Representation of Leumi Overseas Trust Corporation Limited*, the Jersey law position is that no fault is required.

The trustee received its tax advice in February 2000. The tax advice was correct when given but the tax effect of the investments was dramatically changed by the Finance Act 2000 and the consequential changes made to the Taxation of Chargeable Gains Act 1992. Were either or both the trustee and its tax adviser at fault in relation to either of the June or August investments? Should the tax adviser have updated its advice when the tax effects of the transactions on which it had advised changed by virtue of the legislation? Should the trustee have sought an update, at the time of the June and/or August investment? The court made no findings of fault against either party (although the court did raise the argument that the trustee might have refreshed the advice for the August 2000 investment). Having found no fault, the court had to proceed to consider whether fault was a pre-requisite for Hasting-Bass. In the case of *Abacus Trust Co (Isle of Man) v. Barr [2003] Ch 409, Lightman J* had (for the first time in such cases) introduced the requirement to establish fault on the part of the trustee in order to invoke the principle of Hastings-Bass. This had been doubted by Lloyd LJ in *Sieff v. Fox* and the point is essentially undecided in England. However, in *The Representation of Leumi Overseas Trust Corporation Limited*, the Royal Court declined to follow the *Abacus v. Barr* decision in this regard. The ordinary principle underpinning this decision is the desirability to avoid hostile litigation between a settlor and beneficiaries on the one hand and the trustees and their professional advisers on the other hand which could almost certainly follow.

The trustees *would* or *might* have acted differently. What is the appropriate test?

This matter has been left open, but the higher test is likely to be preferred.

The fourth limb of the test set out in *Sieff v. Fox* is that the trustees "would" have acted differently. This is the word used in the Hastings-Bass case itself, although there has been some discussion in England as to whether or not the lower test, namely that they "might" have acted differently, is sufficient. Neither in *Green GLG Trust*, nor in the four recent cases, was it necessary to decide the matter once and for all in Jersey, although in *Green GLG Trust* the Deputy Bailiff did incline towards the higher test. Since in all of these cases the higher test was met, the matter has therefore been left open.

Where there are dramatically adverse tax consequences, the circumstances in which a trustee "might" rather than "would" have gone ahead with the transaction are likely to be few. The matter may be less clear where the exercise of a discretion results in other consequences.

Where foreign agreements are set aside, which law governs the Hastings-Bass application?

The court held that Jersey law should apply.

In *The Representation of Seaton Trustees Limited* of 2007, the Royal Court was asked to set aside two novation and assignment agreements governed by Isle of Man law (which was the law governing the original compensation agreements themselves). The Royal Court needed to decide whether to apply Jersey law to Hastings-Bass relief, or Isle of Man law. Conflict of law principles indicated that invalidating a contract for a factor such as fraud, mistake or misrepresentation requires the factor to meet the standards of the law governing the contract, in this case Isle of Man law. However, in *The Representation of Seaton Trustees Limited,* Commissioner Clyde-Smith applied Jersey law, since the vitiating factor was a defect relating to the exercise of the trustee's discretion. The issue related to the exercise of a discretion made in Jersey by a Jersey incorporated trustee of a Jersey proper law trust. It was a matter within the "domestic confines of this trust". The court was satisfied that the contracts were being set aside as a result of a defect

preceding their execution, rather than a defect in the contracts themselves. In any event, the trustee had obtained an opinion from Isle of Man lawyers indicating that Isle of Man law recognises the Hastings-Bass principle and would be likely to grant the relief sought if the Jersey court so found on the facts. In practice, there no was ascertainable difference between applying the Hastings-Bass principle under Jersey law as opposed to Isle of Man law.

In *The Representation of Seaton Trustees Limited* of 2009, it was accepted that the withdrawals which the trustee sought to set aside were governed by Isle of Man law. Initially, Canada Life International did not comment or consent to the relief sought and the Royal Court expressed concerns about agreeing to set aside a foreign law governed transaction with a foreign party without the latter's consent. However, after the hearing, Canada Life International consented and the court did not need to consider whether to set aside the transaction in circumstances where such an order would, without consent, have no effect.

Can Hastings-Bass relief apply to set aside transactions between trustees and third parties?

The Royal Court held that it can, but only in limited circumstances.

In *The Representation of Seaton Trustees Limited* of 2007, the court was asked to set aside two tripartite agreements. Most Hastings-Bass applications affect a decision in relation to the internal workings of the trust and its beneficiaries. This presented an unusual feature and the third party issue was a concern. The court decided that in general terms it would lead to uncertainty if agreements with third parties could be set aside on the ground of deficiencies in the internal decision-making process of the trustee. The court held that the third party's consent was required. In this particular case, all parties to the contract had consented to the setting aside. Likewise in *The Representation of Seaton Trustees Limited* of 2009, the court did have a serious issue with Canada Life International's position until appropriate consent was obtained.

Can Hastings-Bass relief apply to set aside an agreement where subsequent agreements affecting the subject matter of the first have been concluded?

The court found that the contracts which were set aside did not invalidate subsequent agreements but inferred that, had they done so, this could have meant that the relief would not have been granted.

In *The Representation of Seaton Trustees Limited* of 2007, after signing the two novation agreements, one of the original parties and the new party being the trustees, entered into a series of subsequent agreements affecting the employee benefit rights with third parties under agreements some subject to New York, some to English law and others to Isle of Man law. Legal opinions from New York, English and Isle of Man lawyers indicated that, if the novation agreements were indeed set aside on the facts of this case, that would not affect the legality, validity or enforceability of these subsequent agreements.

Is the transaction void or voidable?

The court determined that it was not necessary to decide this on the basis that it ordered the transactions to be set aside.

The question is whether or not Hastings-Bass relief, if granted, involves a finding that the transaction concerned is void *ab initio* or simply voidable. In *Abacus Trust Co (Isle of Man) v. Barr* it was decided for the first time that Hastings-Bass relief resulted in the transaction becoming voidable. This was considered in *Sieff v. Fox* where an order was made that the transaction concerned be "set aside and declared to be of no effect". This presumably had the appropriate tax consequences in that matter. This was the order sought in each of *Green GLG Trust*, *The Representation of Leumi Overseas Trust Corporation Limited* and *The Representation of Seaton Trustees Limited* of both 2007 and 2009.

Does Hastings-Bass relief apply to administrative decisions as well as dispositive ones?

The Royal Court decided the answer was "yes".

In *The Representation of Seaton Trustees Limited* of 2007, Commissioner Clyde-Smith questioned whether or not the Hastings-Bass principle should be restricted to the exercise of dispositive discretions, or whether it applied to administrative discretions as well. He referred to the indication, in certain English cases, of the reluctance to apply the principle to the latter category of discretions. For example, In *Re Duxbury's Settlement Trusts [1995] 1 WLR 425* the English court declined to apply the doctrine to the appointment of a trustee. Commissioner Clyde-Smith noted that no

such doubts were expressed in the cases of *Barclays Private Bank and Trust (Cayman) Limited v. Chamberlain and other [2004] 9I TELR 302* and *Freidman v. Asia Trust Limited 2006 JRC 187* and could find no reason in principle to distinguish dispositive and administrative discretions in Jersey, stressing that the principle is dependent upon a discretion in circumstances where the trustee is free to decide whether or not to exercise a discretion, rather than on an analysis of the nature of the discretion. This approach was followed by Commissioner Clyde-Smith in the *Representation of Seaton Trustees Limited of 2009*.

What is HMRC's position?

HMRC were notified of all of the recent applications in which Bedell Cristin acted. In each case, HMRC declined an invitation to attend and indicated that it would accept the court's decision provided in one of the cases that a tax bulletin (TB83 June 2006) was brought to the court's attention. In fact, the bulletin was examined by the court in each case. The bulletin contains a number of arguments seeking to restrict the application of the principle, including that the transaction should be rendered voidable as opposed to void and that the principle should not be applied to circumstances where a trustee has relied on incorrect advice. HMRC believe the principle should be restricted to circumstances where a trustee has simply not addressed a particular impact (e.g. fiscal). Commissioner Clyde-Smith declined to make such a distinction, believing that the distinction was based on a policy that a trustee should suffer the tax consequences and pursue its remedies against tax advisers, which is precisely the type of litigation the Royal Court wishes to avoid in granting Hastings-Bass relief. Notably, in *The Representation of Seaton Trustees Limited* of 2009, Commissioner Clyde-Smith commented that HMRC (which had expressed a desire to attend and make representations at one stage) had no *locus standi* to intervene.

In summary, these cases provide a valuable means, where the facts permit it, to enable an error to be put right in the interests of the beneficiaries even if at the probable cost of the hearing falling upon the trustees or their advisers rather than the trust fund or any other party.

All these cases have involved HMRC (as indeed have a number of equivalent English cases). The principle is not confined to circumstances where the trustees would not have exercised their discretion as they did and, as a result, unforeseen tax consequences followed. Other unintended consequences can also invoke the principle. The justification for the principle is to avoid costly and perhaps unsuccessful litigation by beneficiaries involving a number of parties and to negative the windfall tax receipt that HMRC would not have been entitled to had the trustees mistakenly not taken into account the proper factors that they should have considered. It puts the parties in the position they should have been in.

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