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# Tax Advantages for Bungling Trustees

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***Abstract***
Where property is transferred and the manner in which the transaction is carried out results in an unforeseen or unwanted tax liability, what can be done? For individuals, there are some reme

This article first considers the *Hastings-Bass* principle, which stems from case law, and the way in which it is evolving as a tool for trustees to escape from transactions where there are unwelcome tax consequences. Then it will explore the extent to which this goes further than the remedies available to individuals. Finally, it will consider for whose benefit the *Hastings-Bass* principle operates and whether there can be any justification for the difference in treatment between individuals ande b7(d)Tj/489gi8mg47

## 2. THE *HASTINGS-BASS* PRINCIPLE

Whilst the decision in *Hastings-Bass* itself was made in 1975, the principle has, even recently, been described as "emerging" and "developing".[9] In fact, the principle in its current form was not even applied in *Hastings-Bass*, rather it is the principle as

> (b) had he not failed to take into account considerations which he ought to have taken into account."[17]

This is the quotation which has proved fundamental to the development of the principle.[18] The basis is that where the trustee has acted properly within his power, there is no reason for the court to interfere. The court set out clearly in its summary that unless the provisions of its condition were satisfied, a decision taken by a trustee could not be set aside. However, the quotation has often been described as being in a negative form,[19] and it was in the case of *Mettoy* that it was put in the positive form that:

> "where a trustee acts under a discretion given to him by the terms of the trust, the court will interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account."[20]

Whilst many commentators and the case law have seen this to be a mere positive form of what was said in *Hastings-Bass*

lower courts. One reason for this is that often there is no party contesting the setting aside of the transaction and therefore no party to appeal. The only party with an objection is the Revenue, yet, thus far, it has not appeared in the cases following *Hastings-Bass*.

### 3. THE REVENUE'S RELUCTANCE TO PARTICIPATE IN *HASTINGS-BASS* CASES

In many cases, an offer was made to the Revenue to be joined as a party, however it has always refused,[24] although in some cases it has additionally asked for certain authorities to be brought to the attention of the court.[25] Where the court makes an order, only the parties to that order are bound by it. Therefore, it seems possible that the Revenue hopes not be bound by the orders if it does not participate in any way and so does not have to refund (or waive a right to) any tax.[26] In rectification cases, in which the Revenue has also been reluctant to participate,[27] the Revenue has indicated that as long as it was asked to be joined as parties, it will accept the retrospective effect of the order for tax purposes.[28]

Whilst it appears that the reluctance to be joined as a party stems from the Revenue's desire to escape from being bound by the court order, there have not been any cases in which the parties have requested that the court orders be enforced as against the Revenue or that a court order is issued against the Revenue. Therefore, there must be other reasons for the reluctance of the Revenue to be involved thus far. One possible further reason is perhaps that the Revenue does not have the resources to fight each of

had not been carried out, the estate would have passed to the deceased's wife tax free[32] but in the event attracted IHT of over £1million.[33] Lewison J. allowed a transaction to be undone on the basis that the deceased had made a mistake as to his health. However, he also said it was difficult to say for certain that the deceased did indeed have cancer at the relevant date and had the facts been contested, it would have been difficult to make the finding of cancer existing at the time of the transaction.[34] Thus, if the Revenue had not refused to participate in the proceedings,[35] adversarial argument, even just regarding the significance of doctor's reports and the weight that could be attached to vague statements, might have made all the difference.

The fact that the Revenue insists on a court order for the transaction to be set aside before it adjusts any tax consequences is entirely appropriate based on the fact that the parties involved will normally agree to set aside the transaction, as it will be to their benefit. The Revenue should not be forced to accept a reduction in tax with no legal

whether this is actually a deserving case. As will be seen below, outside the context of

consequences of the mistake. Whilst, this distinction is not without its critics,[51] it is still the key test used in the case law.

Second, and more importantly for the current purposes, it has only been in cases where rescission for mistake and rectification are *not* available as remedies that the *Hastings-Bass* principle has been used. Either the other remedies have been argued and discounted or it has been assumed that the other remedies are not available and so the *Hastings-Bass* principle can be used.

Therefore it is clear that whilst individuals do have remedies available to them in order to undo a mistake, they cannot usually escape from the tax consequences of a transaction. The *Hastings-Bass* principle allows a transaction to be undone in cases where an individual would have no success. Thus, there is a difference in the extent to which trustees and individuals can undo transactions for tax purposes.

## 6. TYPES OF MISTAKE RELATING TO TAX

One further issue to consider is whether the type of error relating to taxation should make any difference. A range of tax errors can be at issue when a taxpayer wishes to undo a transaction. The taxpayer may simply be unaware of a tax charge at the time of entering into the transaction, the taxpayer may have received incorrect tax advice relating to the transaction or the taxpayer may have implemented the tax advice incorrectly. In the first circumstance, where the taxpayer is simply unaware of the tax charge, this should not be a sufficient reason to undo the transaction. Many tax consequences can attach to transactions and taxpayers have an obligation to inform themselves of the tax liabilities which flow from a transaction. Therefore the fact that the charge was "unknown" at the time of entering into the transaction cannot be a sufficient mistake to undo the transaction.[52] Certainly if an individual claims he would not have entered into a transaction if he had known the tax consequences of it, there would be no basis for setting aside the transaction. However, in the case of trustees, this issue becomes more complicated, because the trustees have not informed themselves of a factor relevant to the transaction and therefore, they can invoke *Hastings-Bass*.

An example of this is *Burrell v Burrell*[53] which concerned an IHT liability that the trustees had failed to appreciate. The settlor wished to pass some of the substantial shareholding in a company, of which he was chairman, to his family. These shares were of the type that attracted Business Property Relief for IHT purposes,[54] which should have meant that the shares were IHT-exempt on transfer. An A&M trust of the shares was set up in favour of the settlor's son.[55] However, when the son reached the age of majority, the settlor thought the dividends on the shares were too high for someone of such a young age to receive. Therefore, the trustees decided to end the

[51] E.g. J. Hilliard "Limiting *Re Hastings-Bass*" [2004] *Conveyancer* 208 at p.217.

[52] Note, in *Barclays Private Bank*, above, fn.2 the trustees did not take into account a change in the law relating to CGT and this was sufficient to set aside the transaction on the basis that a relevant consideration was not taken into account. If such a rule is allowed to stand, there is no motivation for trustees to inform themselves of the law and keep up to date with it. Further, knowledge of the law and changes in it are imputed to individuals and yet trustees seem to be sheltered from the same.

[53] Above, fn.11.

[54] See ss.l05(1 )(bb) and 122 of the IHTA 1984.

[55] s.71 of the IHTA 1984. The rules relating to the beneficial IHT treatment of these trusts have changed since the Finance Act 2006 (UK), which undertook a major overhaul of the IHT treatment of trusts.

interest in possession and create two new trusts. The shares mentioned previously were transferred into a discretionary trust. Although the shares were eligible for business property relief, which relieves a lifetime charge to IHT on entry into the trust, the shares had to be owned for two years before the transfer to attract the relief.[56] The interest in the shares for IHT purposes only vested in the son when he gained an interest in possession of the trust,[57] which was at the age of 18. The transfer took place when he was 19 and so he had not owned the shares for the requisite period. Thus the transfer into the trust attracted an IHT liability of up to £1.47million. Mann J. suggested that this would be "a very serious loss to the trust estate."[58] Mann J. stated that trustees must consider the tax consequences of their decisions and that failure to do so can trigger the *Hastings-Bass* principle.[59] The trustees had tax consequences in their mind, but they did not give them proper attention.[60]

way to minimise this charge in future. One option given by the advisers was to transfer the property from the original settlement to Lord Howland, the primary beneficiary, contingent on his being alive on a future date. At that time, Lord Howland would resettle the property in a more flexible trust. The trustees were advised that a CGT charge would arise on the transfer of the assets from one trust to the other,[66] but that hold-over relief[67] would be available and so there would be no tax payable at that time. Further, no IHT exit charge[68] on the transfer out of the discretionary trust would be payable as long as the transfer occurred within three months of the 10 year charge.[69] This advice was incorrect because this type of hold-over relief for CGT can only operate where there is an IHT charge. Here, there was no IHT charge, as the transfer was made within three months of the 10 year charge (if this had not been the case, an IHT exit charge would have been payable). Thus no hold over relief was available and the CGT charge of approximately £1million was triggered.

cases. This is because setting aside the transaction will either alleviate a tax burden on the beneficiary himself or on the trust. If the beneficiary's own tax burden is relieved, the benefit to the beneficiary is easy to see. If the trust is relieved of a tax burden, the beneficiary still benefits because there will be more assets in the trust in which they have an interest.[81] However, whilst on the face of it the beneficiary benefits in these cases, in fact it is the trustee who benefits. This is because in overlooking a relevant consideration, the trustee has generally acted either in breach of trust[82] or negligently. Therefore, usually there is a remedy for the beneficiary against the trustee, which would give them compensation for the lost tax.[83] Therefore, whilst the law gives protection to the beneficiary through other action, the *Hastings-Bass* principle in fact protects the trustee from an action being brought against them. In cases where the trustee has simply not recognised that there is a tax liability, he has not fulfilled his obligation to consider all aspects of the transaction. Where the trustee obtains legal advice but does not follow it, again the trustee has made the error and so the remedy sought should be against the trustee. Where the trustee has obtained legal advice but the advice has been given negligently, then the action should lie against the professional adviser and no one else. As stated by Wu,[84] it is a burden on society to undo the transaction where there are other remedies available.[85]

Hilliard has argued that the trustee is not in fact protected by the principle. One reason he gives is that trustees will be protected by a wealth of exemption clauses in the trust documents and so it will be very difficult for beneficiaries to pursue them.[86] However, as Wu points out[87] this is an issue better dealt with by considering the rules relating to exemption clauses. If exemption clauses are available in such a wide range of situations that beneficiaries have no protection as against trustees, perhaps the rules for exemption clauses need to be reconsidered – this is not a reason to provide another legal remedy depriving a different person.[88] On the other hand, if there is a sound basis for the exemption clause rules then the trustees receive protection for sound reasons and the beneficiary should have no claim. The settlor has granted the right to the trustee to be protected against such claims from the beneficiary. Equally, the settlor acknowledges that if the trustee acts in a manner which is outside the bounds of his duty, the beneficiary will receive no protection. Thus, if exemption clauses protect the trustee from rydu clauseshis9

burden of the trustee's error moves to the Revenue because no avenue is available against the trustee.

Hilliard also argues that it is the beneficiary who is being protected because using the *Hastings-Bass* principle means that beneficiaries do not have to become entangled in a hostile negligence claim and they do not have to spend their own money to achieve the remedy. The trustee will often have to pay costs for a case involving the *Hastings-Bass* principle.[89] However, this argument is also weak because in other areas those pursuing a negligence action, for example against a legal adviser, will have to enter into a hostile claim and also pay for this action. There is no reason for which a beneficiary should be sheltered from these consequences.[90] In cases where the trustee has not acted in breach of trust and has not been negligent, and neither has an adviser to the trustee, there is no reason to protect the beneficiary at all and so there is no reason to allow the *Hastings-Bass* principle at all. Whilst the use of it here will not protect the trustee, it should not be available, as there is no policy motivation for allowing a claim in such circumstances.

It has also been argued that to the extent that no third party loses out, the beneficiary should be able to retain this extra level of protection.[91] However, in tax cases there *is* a third party to consider – namely the Revenue.[92] The point in these cases is that a tax liability has arisen. In order to say that the tax liability has, in fact, not arisen, requires a sound basis upon which the legitimate liability can be reversed. The Revenue should be considered as a third party which needs protection because its right to receive the money has arisen and wiping out that right to payment should be treated with the same reverence as in relation to the holder of any other right.[93] The fact that the parties wish it had not arisen simply cannot be sufficient, just as it would not be sufficient if an individual tried to change the tax consequences of a transaction on the basis that they wished a tax liability had not arisen. In so far as third parties should be considered,[94] the right of the Revenue should be equal against trustees as it is against individuals. This issue is related to a public policy argument.[95] If the transaction is set aside and the tax is not payable, society as a whole loses out in order to protect the trustee from a claim against him. The benefit of society as a whole should be put before the protection of a trustee, particularly trustees of the type in these cases who are remunerated for providing a service. There can be no justification for protecting them to the detriment of society as a whole.[96]

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[89] Hilliard, above, fn.51 at pp.207 and 212-213. cf. Dawson, above, fn.85 at p.76.
[90] See Wu, above, fn.75 at pp. 69-70.
[91] Hilliard, above, fn.51 at p.213.
[92] Walker, above, fn.29 at p.240 considers that this might be an option, but that the question is open to debate.
[93] It could be argued that the Revenue is merely a "volunteer" and therefore should not receive protection.

## 8. DIFFERENCE IN TREATMENT BETWEEN AN INDIVIDUAL AND A TRUSTEE

It is clear that trustees are protected from tax errors in a way that individuals are not protected. Furthermore, a professional adviser giving advice to a trustee has more protection than one advising an individual because if they give negligent advice, in the former case the transaction can be overturned, but in the latter case a negligence claim may be possible.[97] The question is then whether there is any justification for this beneficial treatment of trustees. One possible reason why this issue has not been explored in detail in the past (alongside other issues stemming from the *Hastings-Bass* case) could be that it is mainly trust lawyers who have contributed to the discussion in this area, whose whole concern is the relationship between the trustee and beneficiary. From a tax point of view, on the other hand, equity as between taxpayers is a cornerstone of tax policy which should be maintained.[98] This is a very different aim and when considered, a serious unfairness can be seen.

In *Sieff v Fox*

trusts in order to avoid tax.[102] In this context the parties have chosen a more complicated regime of taxation in order to pay less. If that fails and they in fact have to pay as much as, or even more, than if they had not entered into the transaction, then that is again of their own volition – in the desire to minimise the tax, the risk of a more

struck down,[108] the courts are wary of tax avoidance and recognise the need to separate transactions with a true commercial nature from those with the sole aim of avoiding tax.[109] Here we see a contrast with the approach in the *Hastings-Bass* cases, where the courts turn a blind eye to the fact that the transaction is related to tax avoidance and allowed trustees to escape from the tax consequences flowing from a tax avoidance scheme which has been improperly implemented. This is in particular contrast to the tax avoidance cases where the transaction entered into is extremely artificial.[110] In fact, had the Revenue participated in such cases it would be surprising if it did not try to prevent the transaction from being set aside on the basis of tax avoidance. If courts can ignore artificial transactions where they have a tax avoidance purpose, then there is no reason to set aside a transaction which does not achieve its avoidance purpose. This is because, even if the transaction were put in place in the proper manner, the courts would be able to see through the transaction.

The courts need not strike down every tax avoidance scheme, but there is a vast difference between this and aiding taxpayers in their desire to escape tax by helping them to set aside the unwanted consequences of the transaction. Even though tax