Taxing Times for Re Hastings-Bass

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Trustees exercised powers to make capital payments out of the Futter No.3 Settlement to Mr Mark Futter, and out of the Futter No.5 Settlement to his children. They acted on advice from solicitors that the capital gains crystallised by these payments could be set off against the recipient beneficiaries' own capital losses for the purposes of capital gains tax. That advice was incorrect, because of s.2(4) of the Taxation of Chargeable Gains Act 1992, which the solicitors had simply overlooked. In *Futter v Futter* [2010] EWHC 449 (Ch); [2010] S.T.C. 982, the trustees sought a declaration that the purported exercises of their powers were "void and of no effect", with the consequence that no capital gains tax would be payable. They relied on the rule in *Re Hastings-Bass (Deceased)* [1975] Ch. 25. They were successful, and the court granted the declaration sought.

The judge, Norris J., began with Lloyd L.J.'s influential formulation of the rule (*Sieff v Fox* [2005] EWHC 1312; [2005] 1 W.L.R. 3811 at [119]):

> "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 to have taken into account, or taken into account considerations which they ought not to have taken into account."

There are cogent arguments that *Re Hastings-Bass* itself established no such wide principle (Lord Neuberger, "Aspects of the Law of Mistake: Re Hastings-Bass" (2009) 15(4) *Trusts and Trustees* 189). In *Re Hastings-Bass* itself, the question was one of severance: whether an action should stand if some of its effects were achieved, but some were denied effect by law. However, Norris J., sitting at first instance, sought to reconcile and apply the authorities as they have developed, rather than reconsider them.

Correspondingly, the Inland Revenue's attack in *Futter* was confined to challenging the application of the rule (as it has developed) to the particular facts of the case. Its submissions were therefore based on the ways of controlling application of *Re Hastings-Bass* described in *Sieff v Fox* (at [82]), namely: applying the relevant tests stringently; taking a reasonable and "not over-exigent" view of what trustees ought to take into account; and adopting a critical approach to trustees' contentions that they would have acted differently had they known the true position. Unfortunately for the Revenue, *Futter* demonstrates the weakness of those controls in the typical case where the trustees were professionally advised.

Futter therefore raises important questions of principle which should be addressed in an appellate court. First, there is the question of whether the current formulation of the rule in *Re Hastings-Bass*, or something like it, should remain part of the law? Or should the rule return to its more limited origins? Next, if the rule is to continue to exist in something like its present form, what is its rationale? And what, therefore, should be the consequences of infringing the rule?

There is no doubt that the rule in *Re Hastings-Bass* has evolved a long way beyond its origins. That is not necessarily a bad thing. But if such a rule is to continue to exist, it must not be allowed to get out of hand. It assumes that a court can determine what were the relevant considerations that a trustee (or other fiduciary subject to the rule) should have taken into account when making the decision in question, and what were the irrelevant considerations (if any) which he nevertheless took into account. In some contexts, that exercise is relatively easy and uncontroversial. Trustees should clearly take into account the correct taxation consequences of exercising their powers. But, as Lloyd L.J. counselled in *Sieff v Fox* (above), the courts should be careful not to expect too much. So, for example, the rule should only be applied to directors (see *Hunter v Senate Support Services Ltd* [2004] EWHC 1085; [2005] 1 B.C.L.C. 175), if at all, where it is manifestly clear that they have failed to address an obviously relevant factor (e.g. within s.172(1) of the Companies Act 2006) or taken into account something equally obviously irrelevant.

The rationale of the rule in *Re Hastings-Bass* is another area of contention. (See Nolan, "Controlling Fiduciary Power" [2009] C.L.J. 293.) In *Futter*, Norris J. confirmed that it is not about mistake (at [21]). The rule addresses the process of decision-making that antedates and lies behind action taken pursuant to a power. It concerns action which was authorised, both in form and in substance, but was nevertheless taken on the basis of incorrect or inadequate considerations that might, or might not, also amount to "mistakes". (The distinction between mistake and the rule in *Re Hastings-Bass* is illustrated by *Pitt v Holt* [2010] EWHC 45 (Ch); [2010] 1 W.L.R. 1199.)

However, if the courts take the opportunity to reconsider the basis and scope of the rule in *Re Hastings-Bass*, they should also reconsider the law of mistake as it applies to gratuitous transactions. The equitable jurisdiction to set aside a gratuitous transaction for mistake (*Lady Hood of Avalon v MacKinnon* [1909] 1 Ch. 476) survives notwithstanding the demise of equitable mistake as grounds for setting aside a contract in *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2002] EWCA Civ 1407; [2003] Q.B. 679: see *Ogden v Trustees of the RHS Griffiths 2003 Settlement* [2008] EWHC 118 (Ch); [2009] Ch. 162, and *Pitt v Holt* (above). There is little point in re-formulating or limiting the rule in *Re Hastings-Bass* if the consequences are simply to have most of the same claims pleaded and argued instead as cases of mistake and, possibly, to expand further the already wide notion of "mistake". That already seems to include ignorance of facts and consequences, though not yet to include having regard to true, but irrelevant, facts within the second limb of the rule.

Norris J. went on to indicate that the rule in *Re Hastings-Bass* limits the scope of the trustees' power (at [34]), relying inter alia on passages in *Lewin on Trusts*, 18th edn (2007) and *Underhill and Hayton*, 17th edn (2006) to the effect that proper decision making "is requisite for the exercise of a fiduciary power of appointment or advancement, and if not present the exercise will be void in the absence of contrary intent in the trust instrument" (*Underhill and Hayton*, at para.61.22). It is wrong to draw an analogy between the rule in *Re Hastings-Bass* and the doctrine of a fraud on a power, which does limit the scope of a power, so that any purported exercise of a power which amounts to a fraud on the power is void. Of course, it would be possible to make the rule go to the scope of a power by stipulating that the power only exists if the fiduciary has properly determined to exercise it: that is, by implicitly limiting the scope of the power. This is the line taken by the authors of *Underhill and Hayton*. But any such implied limitation on the power is very artificial indeed.

The next question, if the rule survives, is what should be the effect of infringing it? Even Lord Walker has confessed (extra-judicially) to finding the question "difficult" (R. Walker, "The Limits of the principle in Re Hastings-Bass" (2002) 4 P.C.B. 226 at 231). In *Futter*, Norris J. explicitly held that the trustees' purported actions were void in equity—of no effect on the beneficiaries—not voidable.

In principle, the distinction between "void" and "voidable" should turn on the reasons why a transaction or purported transaction can be impugned. If the flaw in what has happened is that the trustees had no authority to act as they did (whether because their conduct was ultra vires or a fraud on the power), then the trustees' actions will be void in equity, though any consequent dealings with trust assets may well have effect at law. By contrast, the rule in *Re Hastings-Bass* concerns the flawed process by which the decision is reached, rather than a lack of authority for the trustees to act lawfully as they did (unless the two are deliberately conflated, which is certainly not necessary). The appropriate consequence of a decision successfully impugned on the basis of the principle should therefore be that the decision and any action taken pursuant to it are voidable in equity, rather than void. Even if the decision is void, like a decision made in breach of fiduciary duty (*Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2002] EWHC 2748; [2003] 2 B.C.L.C. 153 at [91]–[93], per Leslie Kosmin Q.C.), the consequent transaction should still be voidable. (See Nolan, above, at pp.316–323.)

However, the distinction between void and voidable is of very little practical consequence so long as attention remains focused entirely on the trustees and beneficiaries. This has long been known: *Cloutte v Storey* [1911] 1 Ch. 18 at 31, per Farwell L.J.; *Futter* (at [32]); and note by Nolan and Conaglen "Hastings-Bass and third parties" [2006] C.L.J. 15 at 18. Even when the Inland Revenue is brought into the picture, the distinction is of no practical consequence if (as in *Futter*) avoidance of a transaction operates simply to undo the transaction ab initio: in either event, the purported transaction is treated as never having happened, so there can be no tax consequences flowing from it, unless statute provides to the contrary, as it very occasionally does. Admittedly, if the transaction that infringes the rule in *Re Hastings-Bass* is void, not voidable, the Inland Revenue could, without the need for any further action by the trustees or the beneficiaries, levy tax on the basis that the purported transaction is of no effect, a possibility occasionally to the Inland Revenue's advantage. But the Inland Revenue is unlikely to get the evidence to challenge a transaction under the rule without the co-operation of the trustees; so the value of this possibility to the Inland Revenue is largely illusory.

Nevertheless, the distinction between "void" and "voidable" may yet be of importance if the Supreme Court were to refashion the consequences of avoidance under the rule in *Re Hastings-Bass*. Avoidance in this context necessarily means avoidance in equity, which operates by decree of the court, rather than by act of the parties (see Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies*, 4th edn (2002) at paras 24-075–24-085). Perhaps a better remedial approach, and one which would reflect the judicial desire for remedial flexibility in this area, may be to hold that the court can order rescission of the trustee's decision or actions on terms (see N. Langlois and A. Cloherty, "Playing the 'Get Out of Jail Free' Card: Mistake in the Law of Trusts" [2010] J.G.L.R 10 at 26–34). Such remedial flexibility existed in the context of equitable mistake in contract. Though that doctrine was repudiated in *Great Peace Shipping*, its remedial consequences were not. In England, this possibility may be precluded (short of the Supreme Court) by *TSB Bank Plc v Camfield* [1995] 1 W.L.R. 430, though that case is open to significant criticism and appeared to proceed on the (mistaken) assumption that it concerned a *legal* claim for rescission (at 439, per Roch L.J.), which operates by act of the parties, rather than an *equitable* claim, which is only given effect by a decree of the court. What is suggested, therefore, is the protection of a third party's rights (the Revenue's rights) by the imposition of terms even though those rights, being a claim *in personam* for tax due, are not protected by the existing bars to rescission. By contrast, a declaration that the transaction was void, even if only made on terms that tax nevertheless be paid, that would nevertheless amount to unconstitutional imposition of tax by the judiciary in circumstances where, *ex hypothesi*, nothing had happened to trigger a charge to tax duly imposed by legislation.

It may be that rescission on terms is not worth the doctrinal innovation it would undoubtedly involve. If so, the effects of infringing the rule in *Re Hastings-Bass* should at most be confined to the relationship between trustees and their beneficiaries: the rule should simply become an aspect of the trustees' duties of care and skill. And whatever the fate of the rule and its consequences, trustees can always sue their professional advisers for negligence to recover loss to the trust fund caused by bad advice, whether or not the trustees are themselves personally liable to their beneficiaries as a result of following the advice.

A final difficulty with *Futter* is Norris J.'s suggestion that "there must … be a 'change of position' defence" to mitigate the rigours of declaring a transaction which infringes the rule to be "void and of no effect" (at [33]). This sits at odds with the consequence of declaring that the two deeds in *Futter* were void, such that the property passing at law pursuant to them, together with any property now representing it and any relevant income, was held by the recipients on constructive trust. In *Foskett v McKeown* [2001] 1 A.C. 102 Lord Millett made it clear that the change of position defence can have no place in the vindication of property rights (see especially at 129), though the defence would be relevant to any personal claim in unjust enrichment which the trustees might advance as a result of their action being declared void.

The Revenue has recently been much more assertive both onshore and offshore. It has recently been given permission by the Guernsey Court of Appeal to intervene in a *Re Hastings-Bass* application in that jurisdiction involving potential liability to UK income tax: *Gresh v RBC Trust Company (Guernsey) Ltd* [2009–2010] G.L.R. 216 (Royal Court). So it is surely only a matter of time before the rule gets the appellate consideration it deserves.

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Rectification; Trustees' powers and duties; Voidable transactions