



Latest Legislative Developments in the Offshore World

The Honourable Mr Justice David Hayton,
Judge of the Caribbean Court of Justice

Bermuda Transcontinental Trust Conference

Fairmount Southampton

27 April 2015

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Reviews

By

The Honourable Mr Justice David Hayton, Judge of the Caribbean Court of Justice,

On the occasion of

The Bermuda Transcontinental Trust Conference

27 April 2015

1. Setting aside or rectifying errors

A. *The impact of **Futter v HMRC** and **Pitt v HMRC** [2013] UKSC 26*

(1) Setting aside errors in trustees’ exercise of equitable powers where there had been inadequate deliberation by them, but now only if due to breaches of duty by trustees under a restricted Hastings-Bass rule

Trustees had a great liking for the *Hastings-Bass* rule because it enabled them to apply to the court to escape from very detrimental overlooked consequences of exercises of their discretionary distributive powers in favour of beneficiaries. The trustees could have the court set aside what they had done if they would, or perhaps, might¹, not have done it but for failing to take account of a relevant consideration or but for taking account of an irrelevant consideration. Thus overlooked consequences could be undone, most applications concerning overlooked tax liabilities.

The Supreme Court in *Futter*, however, held that trustees’ discretionary distributive decisions will be voidable and so undone - normally only by affected beneficiaries - where the overlooked consequences arose from a breach of duty by trustees e.g. in not being in a position to make a

¹ E.g. in the context of earned pension rights, such as for early ill-health retirement or for “cohabitants”

properly informed decision due to not obtaining advice that they ought to have sought from a person qualified to give relevant advice. Thus, if trustees did take such advice which turned out to be incorrect and so caused loss to the trust fund, nothing can be done except sue the adviser, which may not be straightforward, especially if the adviser has the benefit of an exemption clause.

Where offshore trustees appoint English assets to a beneficiary in circumstances where they would not have done so but for overlooking a relevant factor it seems that this matter affecting the distribution of trust assets falls within Art 8(2)(i) of the Hague Trusts Convention². Thus, it will be governed by the offshore governing law, not the English *lex situs* that normally governs the validity or otherwise of transfers of English assets.

(2) The broadening in Pitt of the equitable jurisdiction so can set aside for mistaken consequences, whether or not due to any breach of duty where trustees involved

The Court of Appeal in *Pitt*³ had refused to set aside a gift creating a discretionary trust where there had been no mistake as to the *effect* of the gift to create a discretionary trust, but a serious mistake as to the disastrous tax *consequences* of creating such a trust. The Supreme Court rejected this distinction between “effect” and “consequences” and held that a gratuitous disposition can be set aside when caused by a mistake of law or fact which had such grave effects or consequences that it would be unjust or unconscionable to refuse relief.

² Incorporated in the Recognition of Trusts Act 1987

³ [2011] EWCA Civ 197, [2012] Ch 132

It stated, however at [114], that relief will not be granted to the donor where “the circumstances are such as to show that he deliberately ran the risk, or must be taken to have run the risk, of being wrong.” This restriction is particularly significant where a person is seeking to avoid tax but gets his arrangements wrong. He cannot be allowed to try and try again until he succeeds in avoiding tax. The Supreme Court even went so far at [135] as to state that in the case of artificial tax avoidance schemes discretionary relief should be refused on grounds of public policy: “artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures.” Even in England, however, it is unlikely that this public policy approach will feature in future cases when England has enacted a General Anti-Abuse Rule⁴ and the courts⁵ have applied principles of statutory construction to frustrate artificial tax avoidance schemes. It is the “running the risk” argument that will feature in future English cases, making it not unconscionable to refuse relief.

Where, offshore trustees mistakenly distribute English trust assets to beneficiaries, however, the offshore trust rules as to setting aside for mistake should apply under Art 8 (2)(i) of The Hague Trusts Convention. But if the mistake of an English settlor relates to transferring English assets to offshore trustees the Convention cannot apply to this preliminary issue so it seems that the English rules as to mistake and “running the risk” should apply, but the proceedings (normally non-adversarial) in the offshore jurisdiction will focus on applying the offshore rules⁶. If, however,

⁴ Part 5 and Sched 43 Finance Act 2013

⁵ *Ramsey v IRC* [1982] AC 300; *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684

⁶ *Re S Trust* [2011] JRC 117, 14 ITEL 663 (transfer of shares in French company to Jersey trustees by a foreign long-time resident in England, deemed domiciled in England for IHT purposes, not treated as governed by French or English law, no-one adversely contesting claim that Jersey law governed the transfer due to the restitutionary obligation of the Jersey trustee in respect of an unjust enrichment)

judgment was obtained against the settlor for English tax, execution could be levied against the English assets.

(3) Rectification of mistakes as to effective meaning of a document but not as to consequences of the rectified meaning

In *Pitt* the Supreme Court made clear at [131] that rectification is concerned with a mistake as to the effective meaning of a document when construing its language in a particular context, not with rectifying errors as to the consequences of the document as retrospectively rectified⁷. While the document may be set aside for a grave mistake as to its consequences this only enables a new prospective disposition of the relevant assets to be made. This may be unfortunate In respect of Inheritance Tax, however, because the seven year period for exempt gifts will start from the date of the new disposition and not the earlier date of the set aside disposition.

B. Position of offshore jurisdictions before Futter

Offshore jurisdictions liked the original *Hastings-Bass* rule that treated breach of duty by a trustee as immaterial and some⁸ treated it as extending beyond a trustee's exercise of *equitable* powers to make gratuitous dispositions in favour of beneficiaries to the exercise of a trustee's *legal* powers of borrowing from a company owned by it or procuring the declaration of dividends to itself from

⁷ *Giles v RNIB* [2014] EWHC 1373 (Ch) at [32]

⁸ *Re Howe Family Trust No 1 Trust* [2007] Jersey RC 278 248, 11 ITEL 14 (trustee's borrowings from owned company to invest directly in Growth Fund followed by loans to settlor both set aside with no adversarial argument, the investment being held on trust for the owned company which would have been used to make the investment but for the trustee overlooking the disastrous tax consequences for the settlor – with a right of reimbursement from the trust – of the trustee directly making the investment.)

a company owned by it⁹. In English law it is likely that such internal trust dealings (as opposed to external dealings with third parties) fall within the restricted *Hastings-Bass* rule but it is not possible¹⁰ to set aside the exercise of legal powers in favour of third parties as voidable under the *Hastings- Bass* rule. In any event, third party purchasers of legal title without notice would be protected under fundamental principles of property law.

Offshore jurisdictions also saw no reason before *Futter* for distinguishing between the effects of a grave mistake or its consequences, such as disastrous tax consequences. They saw no reason to adopt a judicial policy which favours the tax authority to the prejudice of individual citizens and excludes from the ambit of discretionary equitable relief mistakes giving rise to unforeseen fiscal consequences¹¹. “Leviathan can look after itself”¹². Hence Jersey and Isle of Man courts, in order to grant relief for mistaken tax consequences, rejected the distinction between effects and consequences¹³ before the UK Supreme Court did so. Since then, the Jersey Court¹⁴ has ignored the Supreme Court’s “running the risk” argument that might preclude relief being afforded to those involved in avoiding tax, knowing or being taken to know the risks of trying to avoid tax.

C. Legislative Hastings-Bass Responses in Jersey 2013 (Art 47D) and Bermuda 2014 (s47A(7)) for pre- and post-Futter/Pitt events

⁹ *Re Ta-Ming Wang Trust* [2010] Cayman ILR 541

¹⁰ *Donaldson v Smith* [2006] EWHC B9, [2007] WTLR 421 at [54]. Consent of the external third party may enable a trustee to undo the exercise of its discretionary legal powers: *Re the Winton Investment Trust* [2007] JRC 206

¹¹ Hon Anthony Smellie, Cayman CJ, (2014) 20 Trusts & Trustees 1101

¹² *Re R and the S Settlement* [2013] JRC 117 at [39]

¹³ *Re S Trust* [2011] JRC 117, 14 ITELR 663; *Re Betsam Trust* [2009] WTLR 1489

¹⁴ *Re Representation of Boyd, Re The Strathmullan Trust* [2014] JRC 056

(1) More than the exercise of equitable distributive powers in favour of beneficiaries can be set aside

Bermuda's Trustee Amendment Act 2014 adds to the 1975 Trustee Act a s 47A which applies to flawed exercises of a "fiduciary power" defined in s 47A (8) as "any power that, when exercised, must be exercised for the benefit of or taking into account the interests of at least one person other than the person who holds the power" (so extending to the exercise of a testamentary fiduciary power in a will). It will cover not just distributions to beneficiaries but also trustees' internal dealings with companies owned by the trustees e.g. borrowings or procurement of declarations of dividends. A "power" includes "a discretion as to how an obligation is to be performed", so extending to investment and management obligations of trustees that lead them to exercise their powers as legal owners in favour of third parties. However, by s 47A (6) "No order may be made which would prejudice a bona fide purchaser for value of any trust property without notice of the matters which would allow the court to set aside the exercise of a power."

The Trusts (Amendment No 6) (Jersey) Law 2013 that preceded the Bermudian legislation has similar effects, though expressed in more complex fashion. See Art 47 H (2) that makes voidable "the exercise of a power by a trustee or a person exercising a power over, or in relation to, a trust or trust property", where to fall within that clause any power-holder who is not a trustee must (like many protectors) owe fiduciary duties to beneficiaries. This is capable of extending beyond distributive powers to trustees' internal dealings within a structure of companies wholly owned by trustees and to the exercise of investment and management powers creating legal obligations owed to third parties. By Art 47I (4) no order may be made which would prejudice any bona fide purchaser for value of any trust property without notice.

(2) The old Hastings- Bass Rule is retained: no need for any breach of duty

By Bermuda's s 47A(4) it is not necessary to allege and prove "that in the exercise of the power, the person who holds the power or an adviser to such person acted in breach of trust or in breach of duty." By Jersey's Art 47H(4), "It does not matter whether or not the circumstances...occurred as a result of any lack of care or other fault on the part of the trustee or person exercising a power, or on the part of any person giving advice in relation to the exercise of the power."

(3) "Would not" required not merely "might not"

Futter at [91]-[92] deliberately left open whether it had to be shown that the trustees "would not" have done what they did but for whatever they overlooked or whether in some circumstances it would suffice if only the trustees "might not" have done what they did but for whatever they overlooked. It seems that this was to extend the *Hastings-Bass* rule to pension trusts where employees had earned their rights e.g. to early ill –health or disablement retirement or some pension for a person ranking as a 'cohabitant', and the trustees *might* have benefited the employee or his 'cohabitant' but for inadequate investigative steps¹⁵.

Both Bermuda (s 47A(2))and Jersey (Art 47H(3)) limit their legislation to "would not" situations and are so restricted in their scope. Is their legislation to be regarded as comprehensive or does scope remain outside it to assist employees whose claims pursuant to earned rights might not have been rejected but for inadequate deliberations by their trustees? Moreover, will this inadequacy need to be the result of a breach of duty by trustees or will it extend to cases where trustees duly sought advice from a duly qualified person whose advice was erroneous?

¹⁵ See D Hayton {2005} Conv 229 at 237-239

(4) The Court's powers

Under Bermuda's s 47A(1) the court may "(a) set aside the exercise of the power, either in whole or in part, and either unconditionally or on such terms and subject to such conditions as the court may think fit; and (b) make such order consequent upon the setting aside as it thinks fit". Under s 47A(3) to the extent that the exercise of the power is set aside it "shall be treated as never having occurred." This seems a little inflexible e.g. if it means a recipient beneficiary has to return what he received despite a change of position, since this could not have happened if nothing was treated as having been received because the exercise of the power was treated as never having occurred.

In Jersey the exercise of the power "is voidable and (a) has such effect as the court may determine or (b) is of no effect from the time of its exercise." This reflects the English position set out in *Futter* at [92]-[93].

Statutory Jersey jurisdiction to set aside for mistake

Art 47E deals with lifetime transfers or other dispositions to a trust by the settlor or a person empowered to make such a transfer on the settlor's behalf e.g. a receiver holding personal injuries damages for an injured mental patient as in *Pitt*. Art 47G deals with the exercise of powers relating to a trust or trust property by a trustee or another person (whether or not subject to fiduciary duties to beneficiaries: cp Art 47G(1) with 47H(1)).

Where the exercise of a power to make a transfer or disposition to a trust or the exercise of a power in relation to a trust or trust property would not have occurred but for a mistake "of so serious a character as to render it just for the court to make a declaration" the court will intervene. Query if this is a little easier to establish than a "mistake of so serious a character as to render it unjust" if

the court did not intervene, this being the language in *Ogilvie v Littleboy*¹⁶, relied upon by the Supreme Court in focusing at [126] upon “the injustice (or unfairness or unconscionableness) of leaving a mistaken disposition uncorrected.” There must have been some reason for the legislative change of wording.

The declaration will be that the exercise of a power “is voidable and has such effect as the court may determine; or is of no effect from the time of its exercise”: see Arts 47E(2) and 47G(2). By Art 47I(3), without prejudice to its wide powers under Art 51 of the Trusts (Jersey) Law and the protection of bona fide purchasers, “the Court may, consequential upon a declaration made under Arts 47E to 47H, make such order as it thinks fit.”

2. **Reserved powers in Bermudian trusts**

The Trusts (Special Provisions) Amendment Act 2014 inserts s2A into the Trusts (Special Provisions) Act 1989. It states that in his Bermuda trust instrument the settlor can reserve to himself, or grant to others, a limited beneficial interest in the trust property or any or all of a very wide range of powers without prejudicing the integrity of the trust or causing any trust property to be part of the settlor’s estate for the purposes of the Wills Act 1988 e.g. because of the ambulatory nature of the instrument if containing power to amend the trust instrument wholly or partly or a general power of appointment.

This enables the settlor to reserve a large measure of control for himself *or a favoured person* and it provides the same sort of flexibility as found in many offshore statutes. It cannot, however, oust the ability of the courts to find that the trust is a sham if that is the reality of the situation, but makes

¹⁶ (1897) 13 TLR 399 at 400

this unlikely when the trustees' response to the settlor's input is explicable by reference to powers reserved under s 2A.

As to be expected, by s 2A(3) a trustee who has acted or refrained from acting as a result of the valid exercise of any of the reserved powers is not by reason only of such compliance to be liable for a breach of trust. Moreover, by s 2A(5) no person other than a person in whom trust property is vested and who is formally appointed as trustee shall be a trustee by reason only of the reservation or grant of any of the reserved powers.

By s 2A(6) in the reservation or grant of any of the s 2A(2) powers the trust instrument may provide that the holder of such power shall not be subject to any fiduciary duty. This is most useful as in such a case (e.g. a power to replace the trustee or to exclude or add a beneficiary) the exercise of the power is not to be challengeable in the courts unless there is, in effect, 'a fraud upon the power' benefiting a person not within the scope of the power.

By s 2A(7) for trusts created after the commencement of the Act, in the absence of any contrary provision of the trust

- (a) In the case of the reservation by a settlor or the grant to a beneficiary of any of the s 2A(2) powers such powers shall be presumed to be personal and non-fiduciary so long as the power-holder is not the sole trustee; and (b) In any other case, such powers shall be fiduciary.

Express provision should be made in the trust instrument if the presumptions are to be ousted, so powers of someone other than a settlor or beneficiary acting as protector can be purely personal, so, no core fiduciary duties.

Unaccountability of trustee except to a dictatorial settlor or a “kingpin”

S 2A(4) is of particular significance. It states, “Where a power to revoke, a general power of appointment or the present beneficial interest in respect of all or part of the trust property is reserved or granted to a person, a trust *instrument may provide that* for so long as the settlor, beneficiary or other holder of the power is not the sole trustee, the *trustee shall owe no duty to any other person* in relation to all or such part of the trust property and accordingly *shall have no responsibility to any other person* for acts or omissions occurring during that person’s lifetime in respect of that property.”

Is this not likely to be analysed as follows? If the settlor has a power of revocation or a general power of appointment (each enabling him to recover the trust property) or a life interest, so long as the trust instrument states that the trustee shall have no duty to any other person, no other person interested in the trust as potentially benefiting from it can complain about the trustee’s acts or omissions occurring during the settlor’s lifetime, nor, it follows, seek information from the trustee about such matters. The existence of a trust obligation requires a duty owed by a trustee to someone who can only be the settlor. Whereas the beneficiaries’ interests on the face of it *appear* to be present interests defeasible upon the settlor’s exercise of a power of revocation or a general power or *appear* to be interests in remainder after the settlor’s life interest, the trustee owes them no duty for any acts or omissions during the settlor’s lifetime, owing a duty exclusively to the settlor, who may do what he wants with what is essentially still his property. Thus, trust assets may be invested or speculated with howsoever and may be distributed to the settlor or non-beneficiaries without the beneficiaries being able to object and so without them having any interest entitling them to invoke the supervisory jurisdiction of the court.

The reality seems to be that in the settlor's lifetime the property is held to his order, without any need for him first to have exercised any power of revocation or general power e.g. in signed writing.

The position will be similar where it is another "kingpin" person e.g. a wife or widow or favoured child, who holds a general power¹⁷. No person other than the settlor or the kingpin, as the case may be, has any rights against the trustee whose only duty is to one of them. Only on the death of the settlor or kingpin do the "beneficiaries" acquire rights against the trustee which are restricted to acts or omissions occurring after such death in respect of whatever of the original trust property and its traceable proceeds happened to remain in the trust fund.

Normally, this would mean that the settlor or kingpin had an absolute equitable interest in capital and income which would fall into his estate to be disposed of by his formal will or the intestacy rules and to be available for claims of creditors, heirs and spouses.

The impact of s 2A(1)(c)

What, however, is the impact of s 2A(1)(c) which states that the powers and/or beneficial interest of a *settlor* set out in s 2A(2) shall not cause the trust property to be part of the "estate of the settlor for purposes of the Wills Act 1988", enabling by s 5 "every person to dispose, by will executed in accordance with this Act, of all real estate and all personal estate owned by him at the time of his death." It seems that it will have no impact on the s 2A(4) extreme situation of accountability only to a settlor or "kingpin" because it appears to have been designed just to deal with a *settlor* having

¹⁷ It seems a life tenant may be in a similar position since the trustee owes no duty to anyone else and so cannot be liable for transferring the trust property to the life tenant or his nominees. The trustee, after all, has to owe a duty to someone for a trust to exist and this someone is the life tenant whom he must obey, especially if the life tenant has a purely personal power to replace the trustee.

reserved powers or a beneficial interest within subsection (2), not the dictatorial position under subsection (4), and does not deal with “kingpins”.

Where s 2A(1)(c) is applicable to ordinary reserved powers trusts it means that the trust instrument does not need to be executed like a will and the trust property, if situated in Bermuda, is not part of the *settlor's* estate for satisfying claims of creditors, heirs and spouses, without prejudice to the position of a non-settlor with a general power for instance. In respect, however, of trust property and underlying assets (like property held by a company owned by Bermudian trustees) located outside Bermuda the *lex situs* may take its own view on what is to be characterised as part of a deceased's estate or patrimony. It may regard some reserved powers as so broad (e.g. a power of revocation or a general power of appointment or a power to amend the trust instrument in any way) as to enable the trust property to be regarded as part of the deceased's estate for claims by creditors, heirs and spouses.

Compare s 3 Bahamas Trustee Act 1998

Here it is worthwhile looking at s 3 of the Bahamas Trust Act 1998, especially if Bermuda might think of extending its s 2A(1)(c) protection to dictatorial trusts within s 2A(4). By s 3 where “The retention of ... (j) any beneficial interests of the settlor (including *absolute beneficial interests*) in the capital or income of the trust property or *in both such capital and income*” “shall not invalidate a trust or the trust instrument or cause a trust created inter vivos to be a testamentary trust or disposition or the trust instrument creating it to be a testamentary document.”

Thus, take a trust of capital and income for S absolutely, with remainder to his three children equally or as he may otherwise appoint in writing. English law treats this as if T held the trust property for S absolutely, S being full equitable owner of the property, so that for him to pass on to his children whatever property remained in the trust on his death would require a duly executed

will. Bahamas law however, is to the contrary but it does not have extra-territorial effect on foreign property and cannot bind other countries' courts which may characterise S's inter vivos settlement as testamentary, needing Wills Act formalities, and even if those formalities had been present could still regard S's equitable interest in the trust property in their jurisdiction as part of his estate available for creditors, heirs and spouses.

A final caveat

Always beware the *lex situs* with its pragmatic territorial power and its capacity to have different characterisations e.g. where a forced heirship claim concerning the deceased settlor is brought in a foreign civilian court and the court treats inter vivos gifts of foreign property as a matter governed by succession law.