Some Current Trust Law Issues 2010

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

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Remarks

By

The Honourable Mr Justice David Hayton[1], Judge of the Caribbean Court of Justice,

On the occasion of

The Transcontinental Trust Conference

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1. Valid trusts or voidable for mistake?

Serious mistakes as to the effect of a disposition

In *Ogilvie v Littleboy*[2] the Court of Appeal rejected an unmeritorious appeal by an exceptionally wealthy settlor who had been fully advised by experienced lawyers as to the effect of her charitable settlement yet claimed she had not appreciated its full effect so that it should be set aside for her mistake. Lindley LJ, with whom, on a further appeal to the Lords, Lord Halsbury agreed entirely[3], stated a very broad approach:

> *'a donor can only obtain back property which he has given away by showing that he was under some mistake of so serious a character as to render it unjust on the part of the donee to retain the property.'*

[1] Caribbean Court of Justice. I have easily persuaded myself as to the views expressed herein, but these views may, of course, change after the benefit of any forensic argument thereon.

[2] (1897) 13 TLR 399 at 400.

[3] (1899) 15 TLR 294 at 295 per Lord Halsbury referring to 'circumstances where misunderstanding on both sides may render it unjust to the giver that the gift should be retained'.

In *Gibbon v Mitchell*[4], where a life tenant under a protective trust mistakenly believed he could surrender his life interest to benefit his children as remaindermen but, instead, caused its forfeiture and the creation of a discretionary trust for him and his children, Millett J set aside the surrender, summarising the effect of many cases cited to him (but *Ogilvie* had not been cited to him) as showing that the court will set aside a voluntary transaction:

> *'if the court is satisfied that the disponor did not intend the transaction to have the effect which it did. It will be set aside whether the mistake is of law or of fact, so long as the mistake is as to the effect of the transaction itself and not merely as to its consequences or the advantages to be gained by entering into it*[5]*.'*

This passage was cited approvingly by the Court of Appeal in *Allnutt v Wilding*[6], a case where, after the settlor's death, the trustees of his voluntary settlement sought to have the court rectify it. The 82 years old settlor had a general intention to make a PET to benefit his children and his grandchildren after his death and, in accordance with his solicitor's advice that the settlement deed would help him achieve what was desired, he executed it and then transferred £550,000 into it. This settlement, however, amounted to a discretionary settlement for his three children and their issue born within an 80 year perpetuity period with a power to accumulate income for 21 years[7], so that a transfer into it could not rank as a PET. If, however, the settlement had been an interest

[4] [1990] 1 WLR 1305.
[5] [1990] 1 WLR 1304 at 1309.
[6] [2007] EWCA Civ. 412 [2007] WTLR 941 at [6].
[7] See Rimer J in *Allnutt v Allnutt* [2006] EWHC 1905 (Ch) [2006] WTLR 1317 at [11].

in possession settlement for the lives of the three children a transfer into it would have ranked as a PET.

The Court of Appeal held that the trustees had failed to establish a mistake such as would justify the intervention of the court"[8]. As Mummery LJ stated,

> "*I am unable to see any mistake by the settlor in the recording of his intentions in the settlement. The mistake of the settlor and his advisers was in believing that the nature of the trusts declared in the settlement created a situation in which the subsequent transfer of funds by him to the trustees would qualify as a PET and could, if he survived long enough, result in the saving of inheritance tax. That sort of mistake about the potential fiscal effects of a payment following the execution of the settlement does not, in my judgment, satisfy the necessary conditions for the grant of rectification*[9]."

No opinion was expressed on whether or not the settlement could have been set aside for such a mistake as to fiscal consequences because setting it aside would make it fall into the deceased settlor's estate and make it liable to inheritance tax, so that such relief was not sought[10]. Earlier[11], however, Mummery LJ had stated Rectification is but one aspect of a wider equitable jurisdiction

[8] Per Carnwath LJ at [26], reflecting Mummery LJ at [20]. A subsidiary reason for rejecting the claim was that the trustee failed to show what were the different trusts and powers intended to be in an IIP settlement.
[9] At [20]. Hooper LJ simply agreed at [28].while Carnwath LJ agreed at [26]-[27]. In ignorance of *Allnutt v Wilding*, the Bailiff of Jersey in an unopposed application in *Re Representation of Sanne Trust Co Ltd*[2009] JRC 025A, a case very similar to *Allnutt,* did rectify a 1999 discretionary family settlement into an interest in possession settlement where the mistake had been as to the fiscal consequences, the Bailiff at *13+ stating 'that there has been full and frank disclosure' as required for a rectification claim to succeed. At *14+ the Bailiff stated, 'The Court was informed of correspondence between Messrs Lawrence Graham and HMRC Capital Taxes Office which was content to rest on the decision of this Court.' Surprisingly, the CTO did not request the Court to consider the limitation on rectification enunciated in *Allnutt.*
[10] See [8] and [21].
[11] At [5] and [6] and [7] respectively.

to relieve parties from the consequences of their mistakes, that the judgment of Millett J in *Gibbon* is a valuable illustration of the limits of rectification, and that, although Millett J"s dicta were concerned with refusing to set aside a disposition where the disponor's mistake had been as to the consequences or the advantages to be gained by making the disposition, Millett J made it clear that that it was not a mistake of the kind for which rectification was available."

Thus rectification will be available where there is a mistake as to the effect of the transaction itself (eg believing that a covenant to make a payment of £x free of tax was effective as such, instead of the formula to make such a payment as after the deduction of tax will amount to £x[12]) and not merely as to its consequences or advantages, whether fiscal or otherwise. Similarly, setting aside a gratuitous disposition for mistake will be available where the mistake is as to the effect of the disposition itself and not merely as to its consequences or advantages. Such a mistake is clearly an operative mistake making it unjust for the donee to retain the property within Lindley LJ"s very broad approach in *Ogilvie*.

Serious mistake as to indirect effects or as to facts

The effect of the transaction, however, extends to its inevitable indirect effect as held in *Anker-Petersen v Christensen*[13], where the claimants deliberately assigned their interests under will trusts to "intermediate trustees" for settlement on new trusts, which they had understood were to be substantially the same as the will trusts, but which were significantly different, so the assignments

[12] *Jervis v Howle* [1937] Ch 67 (rectification to use the proper formula). Also see rectification where a client intended tax-effective deed of variation of a will, but his solicitor mistakenly omitted the relevant statutory references in the deed (*Wills v Gibbs* [2007] EWHC 3361 (Ch)) or where a client intended a tax-effective standard accumulation & maintenance settlement but his solicitor mistakenly inserted an age above 25 (*Bartlam v Coutts* [2006] EWHC 1502 [2006] WTLR 1165).

[13] [2001] EWHC B3 (Ch) [2002] WTLR 313.

were set aside Similarly, where H made an outright gift to W, fully intending to make such gift, but was mistaken as to its indirect effect, which was for it to be caught by W"s after-acquired property covenant in her marriage settlement so as to be held on trust for her for life, the court set the gift aside: *Ellis v Ellis*[14].

Again, in *Lady Hood of Avalon v Mackinnon* [15] (not cited in *Gibbon v Mitchell*) Lady Hood in 1904 by deed appointed £8,600 to her elder daughter, fully appreciating this, intending to maintain equality with her younger daughter who had just had money appointed to her, but in fact making her elder daughter much better off than her younger daughter because the elder daughter had earlier been paid her due share in 1888 on her marriage. As Eve J said,[16] "It was obviously a mistake because the effect of the execution of that deed was to bring about that which Lady Hood never intended and never contemplated. I think she executed the deed under a mistake with regard to the existing facts."

This last sentence was seized upon by Lewison J in *Re Griffiths*[17] where G deliberately made a transfer of property which actually took effect as a PET, initially exempt from IHT and which would remain exempt if G survived long enough as explained to him by his tax lawyer, though he rejected his lawyer's advice to insure against the risk of an early death. At the time of the transfer, unbeknown to G, he was suffering from terminal cancer causing his death just over a year later and so occasioning a full charge to IHT, so that if G Had known of his cancer he would not have

[14] (1909) 26 TLR 166.
[15] [1909] 1 Ch 476.
[16] At 484.
[17] [2008] EWHC 118 (Ch) [2009] Ch 162.

made his transfer of property. This transfer was set aside because made under a serious mistake as to existing facts, following *Lady Hood*, the judge feeling fortified by Lindley LJ's approach in *Ogilvie*, but two earlier PETS made when not suffering from cancer were not set aside – the mere subsequent falsification of expectations entertained at the date of the transaction is not enough[18].

Lewison J considered[19] that there had been no mistake as to the effect of the transfer as a PET, pointed out[20] that Millett J had not said that a voluntary transfer will *only* be set aside if the court is satisfied that the disponor did not intend the transfer to have the effect it did, and held[21] „a mistake about an existing or pre-existing fact if sufficiently serious is enough to bring the jurisdiction into play. If and to the extent that Millett J intended to restrict the scope of the equitable jurisdiction to a mistake about the effect of a transaction, I respectfully disagree." Thus the transfer could be set aside even though there had been no mistake at the time of the transfer as to it qualifying as a PET.

Serious mistake not about the effect of a disposition but as to its consequences

What then of the position where there has been a mistake as to a transfer into a settlement qualifying as a PET (so it does not so qualify), though there was no mistake about the effect of the

[18] See [23].
[19] At [23].

[20] At [24].
[21] At [25], unsurprisingly accepted by a Deputy Judge in *Bhatt v Bhatt* [2009] EWHC 734 (Ch) at [29], though the voluntary documents were set aside at [35] because no explanation of the serious prejudicial effects of the documents (eg losing control of her home) had been provided and, if provided to her, she would not have executed the documents: *Phillipson v Kerry* (1863) 32 Beav 628 applied.

settlement as such in conferring interests and imposing duties? Is such a mistake not as to the effect of the transaction itself but merely as to its fiscal consequences or advantages, so that the transfer and settlement of property cannot be set aside?

Can they, however, be set aside aside merely because made under some mistake of so serious a character as to render it unjust on the part of the donee to retain the property" in the words of Lindley LJ in *Ogilvie,* so that it suffices that the transferor would not have made the transfer but for the mistake, or must one go further and show that „the mistake [was] as to the effect of the settlement and not as to its fiscal consequences or advantages" as indicated by Millett J in *Gibbon* and also by Davis J in *Anker-Petersen*[22]? Has the case law since *Ogilvie* not worked out and refined Lindley LJ"s broad approach, so that for a mistake to be an operative one it needs to be as to the direct or indirect effect of the transaction itself or as to existing facts as in *Lady Hood,* but not merely as to the consequences or advantages to be gained from the relevant voluntary transaction?

One must go further than the broad approach of Lindley LJ according to dicta of the Deputy Judge, Robert Englehart QC, in *Pitt v Holt*[23] who thought that there was no divergence between the views of Lindley LJ and Millett J, the former being concerned with the seriousness of the mistake and the latter with the type of operative mistake, and regarding an Isle of Man case, *Re Betsam*[24] as not in accord with English law.

[22] [2001] EWHC B3 [2002] WTLR 313 at[37]-[38]
[23] [2010] EWHC 45 (Ch), [2010] 2 All ER 774 at [49] – [54]

[24] [2009] WTLR 1489

In *Re Betsam* the Deputy Deemster applied Lindley LJ"s broad approach, believing *Re Griffiths* to have been founded upon that (though, in my view, it was founded upon *Lady Hood*) and rejected the Millett J qualification. Thus he set aside a settlor"s disposition as to the effect of which there was no mistake, though the settlor would not have made it but for a mistake of law as to its fiscal consequences, overlooking that he was deemed domiciled in the UK under s 267 Inheritance Act 1984.

Re Betsam's application of Lindley LJ"s broad approach was followed by the Jersey Royal Court in *Re The A Trust, B v C, D and E*[25] where a settlor"s trust and disposition of assets to the trustee were set aside because of a mistake of law as to the fiscal consequences thereof: an immediate IHT charge arose because the settlor"s UK residence for 17 out of the last 20 years meant she was deemed domiciled in the UK for IHT purposes (though not for income tax or capital gains tax purposes). There was, however, no mistake as to the effect of her acts in transferring assets to a settlement conferring particular interests and imposing various duties.

To my mind, by taking account of fiscal consequences *Re Betsam* and *Re The A Trust*, in the absence of countervailing submissions on the lines herein, have extended the law too far in a fashion convenient for settlors and their advisers and the parties involved in the applications. The position should be as broadly stated by Lindley LJ in *Ogilvie* but as worked out and refined in *Lady Hood* and *Gibbon*, while I have some doubts (see later in discussing limits upon the *Hastings*-

[25] [2009] JRC 245 followed in *Re First Conferences Ltd 2003 Employee Benefit Trust* [2010] JRC 055A and *Re Lochmore Trust* [2010] JRC 068

Bass principle) over the application of *Lady Hood* in *Griffiths* where the transferor deliberately took a gamble on his longevity though advised to take out insurance.

But are not fiscal consequences relevant for Hastings-Bass vitiating trustees' decisions?

I say fiscal consequences should not have been taken into account in *Betsam* and the *A Trust*, even though one may argue that one should take account of the fiscal consequences of *individuals'* actions when the fiscal consequences of *trustees'* actions are taken into account for invalidating their actions under the *Hastings-Bass* principle, as best summarised in *Sieff v Fox*[26] by Lloyd LJ (in giving his reserved judgment in the High Court case heard before his elevation)? That case established that if *trustees* would not have acted as they did (in exercising their equitable distributive powers[27]) but for failing to take account of a material consideration, extending to the significant fiscal consequences of their action, that action will be void eg if purporting to re-settle or subsettle on new trusts. While Lloyd LJ accepted[28] that *Ogilvie's* broad formula „might allow fiscal consequences to be taken into account if they were sufficiently serious" so that a voluntary disposition by an individual who had mistakenly overlooked fiscal consequences could then be set aside for mistake , he did[29], however, specifically refer to the different circumstances of individual

[26] [2005] 1 WLR 3811 at [119].

[27] As opposed to accepting property from the settlor as prime mover (*Smithson v Hamilton* [2007] EWHC 2903 (Ch),2008] 1 WLR 1453 at [90] and *97+ endorsed by Lord Neuberger in 'Aspects of the Law of Mistake' in STEP's 2009 Vol 7 Issue 2, Trust Quarterly Review 5 at 8) or exercising legal administrative or management powers subject to duties of care and skill: DJ Hayton 'A Review of Current Trust Law Issues' (2008) 22 Trust LI 81 at 87 doubting *Seaton Trustees v Morgan*[2006] JRC206 sub nom *Re Winton Investment Trust* [2008] WTLR 553 and *Barclays Private Bank & Trust (Cayman) Ltd v Chamberlain* [2007] WTLR 1697.

[28] At [106].

[29] At [85] and [108].

donors (who owe no duties to anyone as to how to deal with their own assets) and trustees, and the different situations in which they come to make a disposition as sufficient to explain and justify the existence of different rules, and deliberately left the position open.

Since then, in *Pitt* v *Holt*[30] it has been emphasised that, while a failure by *trustees* to take account of material considerations will make their decisions void, a failure by an *individual* to take account of material considerations will not make his decisions impeachable: a person can be as foolish and reckless as he likes with regard to his own property but a trustee owes many duties to beneficiaries in exercising his powers over trust property.

Moreover, in *Futter v Futter*[31] Norris J made it clear that the *Hasting –Bass* principle is not concerned with the law of mistake (which leads to dispositions being *voidable*) but with the law relating to the exercise of trustees‟ equitable powers which requires the trustees to take account of all material considerations, including the fiscal consequences of proposed actions, with the sanction that such actions will be declared *void* if those considerations and consequences are not taken into account. Even if the trustees make no mistake at all because not giving any thought at all to what should have been a material consideration, the *Hastings-Bass* principle is applicable.

While referring to the *Hastings-Bass* principle, its non-application to one situation may have implications when considering whether to set aside a voluntary transfer in a situation as in *Griffiths*. Take the case where trustees take specialist tax advice that taking course „X‟ has a 3:1 chance of

[30] [2010] EWHC 236 (Ch) at [21].

[31] [2010] EWHC 449 (Ch) at [21] – [25] and [33] – [35].

avoiding tax as opposed to taking course „Y‟, so they take course „X‟. Fine, if course „X‟ works. If it does not, then they will argue that they achieved something they did not intend to achieve and that they would not have taken course „X‟ if they had known it would not avoid tax, so the position should be as if they had taken no action under the negating effect of *Hastings-Bass*[32]. The counterargument is that they had not failed to take account of a material consideration, namely the fiscal consequences of their action; indeed, they had fully considered the fiscal situation and taken the risk of course „X‟ failing. Thus the court will not interfere with the exercise of the trustees‟ discretion.

Re Griffiths re-considered

Now, take the facts of *Re Griffiths* where specialist tax advice was taken to make a transfer that did actually qualify as a PET, so that no IHT was immediately payable and no IHT would later become payable if the transferor survived long enough. The transferor, G, was advised that he had to face up to the risk of not surviving for long enough and either take the risk or insure against it. G gambled on taking the risk because he did not follow his advisor‟s recommendation to take out term insurance (when he would have received cover or discovered from the medical examination taken to obtain the insurance that he was uninsurable). Then in one scenario it turns out that, unbeknown to him, at the date of the transfer he was suffering from a terminal illness causing death a year later, so falsifying his expectations. In a second scenario this terminal illness starts six months after the transfer before causing death a year later, so falsifying his expectations. Why

[32] They cannot be treated positively as having adopted course Y: *Breadner v Granville-Grossman* [2001] Ch 523.

should the transferred property fall back into the transferor"s estate to the prejudice of the transferee in the first scenario but not in the second? Should things not be left as as they are, the transferor"s knowing gamble not having paid off? In such fashion "the cookie crumbles and the mop flops", the *Lady Hood* case, on which *Griffiths* was based, not being one involving the knowing taking of a risk, let alone an obvious tax risk.

As Lord Hoffmann stated in *Deutsche Morgan Grenfell v HM Commissioners of Inland Revenue* [2006] UKHL 49 at [26] when considering a cause of action for „relief from the consequences of a mistake" within Limitation Act 1980 s 32(1)(c), "The real point is whether the person who made the payment took the risk that he might be wrong. If he did then he cannot recover the money", so, as Tomlinson J accepted in *Kommune v DEPFA ACS Bank*[33], "conscious risk-taking would preclude recovery on the basis of mistake." Indeed, Lord Scott in *Deutsche*[34] gave the example of "a gift of £1000 by A to B when B is believed to be impecunious but is, in fact, a person of substantial wealth and where A would not have made the gift if he had known that to be so. My present opinion is that unless there were some other reason, such as a misrepresentation by B, to enable the gift to be set aside, the mistake made by A would not suffice, notwithstanding that the payment would not have been made pursuant to any legal obligation and that but for the mistake it would not have been made."

[33] [2009] EWHC 2227 (Comm) at [144]

[34] [2006] UKHL 49 at [87]

Defences for a transferee of a disposition void in equity under Hastings-Bass

While dealing with the clarification of the *Hastings-Bass* principle in *Futter v Futter* it is worth noting that Norris J briefly stated that the transferee will hold the mistakenly transferred property as constructive trustee[35] for the trustee-transferor except to the extent that he may have some defence by way of laches, acquiescence or change of position[36]. The basis for this must be that the trustee-transferor has validly transferred the legal title, which the transferee can pass on to others[37], but there has been no transfer of the beneficial interest, so the transferee holds the legal title on constructive trust for the trustee-transferor. If the transferee (or a donee from him) still has the property the transferor is entitled to recover the property as *his property* (qua trustee if a trustee-transferor). His claim is founded on property law not on the law of unjust enrichment and so the defence of change of position is not available[38], though an equitable allowance could be made in the transferee"s favour to the extent that he had improved the property before becoming aware of the mistake.

If, before such awareness, the transferee had sold the property and dissipated the proceeds, no proprietary remedy via the tracing process would be possible nor could any personal claim be made

[35] [2010] EWHC 449 (Ch) at [35].
[36] Ibid at [33].

[37] These will also acquire the beneficial interest if bona fide purchasers for value without notice.
[38] *Foskett v McKeown* [2001] 1 AC 102 at 108-109, 127, 129 and 132.

against the transferee as an innocent volunteer[39]. If, instead, the proceeds had been invested in purchasing a lottery ticket and a life policy on the transferee‟s life the transferor can seek to take advantage of the tracing process to claim the ticket and the policy. One view is that the transferor claims them as his property, so that the defence of change of position is not available. The better view appears to me to be that that would be the case if someone who had undertaken the office of *trustee* had wrongfully sold trust property and then used the proceeds to buy for himself a lottery ticket and a life policy, such trustee by virtue of having undertaken the trusteeship not being able to deny his beneficiaries‟ claim that he bought such property for the trust and not for himself[40]. An *innocent volunteer*, however, can validly claim that he bought the property for himself so that it is *his property* that the transferor is claiming and, therefore, the transferor‟s claim can only be founded on the transferee being unjustly enriched at the transferor‟s expense if allowed to keep the benefit of such property acquired by virtue of using the proceeds of sale of the transferor‟s property. Thus, if, say, the transferee died just after the transferor‟s claim was made against him so that his payment of £50,000 on his life policy produced £1million, the transferee‟s executor could justifiably claim that the transferee had been unjustly enriched only to the extent of £50,000 and so only that amount could be recovered by the transferor. Similarly, if £10 had been used to buy a lottery ticket that won a prize of £100,000 only £10 could be recovered by the transferor,

[39] *Allan v Rea Brothers Trustees Ltd* [2002] EWCA Civ 85 (2002) 1 ITELR 627 at [52]-[55], *Primlake Ltd v Matthews Associates* [2006] EWHC 1127 (Ch) at [336].

[40] As in *Foskett v McKeown* [2001] 1 AC 102 where the trustee wrongfully used trust money to pay for two fifths of the premiums on a life policy for himself, so his heirs as donees automatically held two fifths of this policy and its proceeds for the trust beneficiaries.

especially if the transferee could have, and would have, bought the ticket with his own money if knowing the original transfer of property to him was a mistake[41].

2. The reflective loss principle and losses in underlying companies of trusts

The reflective loss principle

If a company suffers losses due to a breach of duty owed to it (eg under a contract or the law of tort), it owns a legal *chose in action* as part of its assets and it alone can sue on it. A shareholder cannot sue on it, unless the circumstances are exceptional so that the shareholder may bring a derivative action in right of the company and recover damages on its behalf e.g. where as a fraud on the minority the controllers of the company refuse to sue.

While the loss inflicted by the wrongdoer on the company may well be reflected in the diminished value of the shareholders‟ shares, normally the wrongdoer‟s actions will not have been a breach of any duty owed to the shareholders.

Exceptionally, the company may suffer loss caused by a breach of duty by a wrongdoer who is also in breach of a duty to a shareholder eg for the tort of deceit, whose loss merely reflects the loss suffered by the company. Double recovery of damages by the company and the shareholder cannot be allowed, and protection of the company‟s creditors, in case at the date of receiving the damages the company is about to be wound up or go into administrative receivership, requires that

[41] See *Re Tilley's WT* [1967] Ch 1179 (no proprietary share, only a lien for the money, which is fine for an innocent donee, but Mrs Tilley as trustee could not be "innocent") and *Foskett v McKeown* [2001] 1 AC 102 at 112-113 per Lord Steyn, though overlooking the innocent donees' derivative liability as explained in the preceding footnote.

the company alone can recover for its losses and the shareholder cannot recover his reflective loss[42]. If the damages were paid directly to the shareholder the money would not be available to the company‟s creditors as company funds and so the shareholders could wrongly obtain priority over the creditors[43].

On this basis, what is to happen where a company is unable to pursue its claim against the defendant as a result of his wrongdoing? Let us say that a wrongdoer siphons off the company‟s business intending it to be denuded of funds so that it will be unable successfully to sue him. When it does issue legal proceedings he obtains a security for costs order against it with which it cannot comply, so the action is discontinued. If a shareholder is allowed to sue for his own losses, the company being in administrative receivership, the money recovered by him will not be available to the company‟s creditors as company funds so that, unjustifiably, he will have obtained priority over the creditors. Despite this, the Court of Appeal in *Giles v Rhind*[44] exceptionally allowed the shareholder so to sue on his own behalf, though Lord Millett for the Hong Kong Final Court of Appeal in *Waddington v Chan*[45] rejected the Court of Appeal‟s approach. He explained that the shareholder should have applied for the court to direct the administrative receiver to bring an action to enforce the company‟s rights if the shareholder was willing to fund it, while if the company had

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[42] *Johnson v Gore-Wood Co* [2000] UKHL 65 [2002] 2 AC 1 expounding upon *Prudential Assurance Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204, CA

[43] Similarly, in the rare case where not only the trustee (eg of a unit trust) has a cause of action against a third party (eg an auditor having statutory duties) but also the beneficiaries (eg unit holders) with reflective losses, the beneficiaries cannot sue in respect of the reflective losses because the damages must be paid to the trustee so as to safeguard the priority of creditors via their subrogation rights against the trustee's right to an indemnity out of the trust fund, which has priority over the beneficiaries' interests in the net fund. In *Mercedes Holdings Pty Ltd v Waters (No 2)* [2010] FCAustralia 472 at [111]-[112] Perram J did not appreciate this, due, it seems, to a misconception of the justification for the reflective loss principle in the company law context.

[44] [2002] EWCA Civ. 1428 [2003] Ch 618

[45] [2008] HKFCA 63 [2008] HKLR 1381 at [82] – [88].

not been in receivership the shareholder could have brought a derivative action in right of the company. Despite this, the Court of Appeal in *Webster v Sandersons Solicitors*[46] considered itself bound by *Giles* under the English doctrine of precedent, leaving it to the Supreme Court in due course to overrule *Giles* if it thought appropriate.

Anyhow, leaving aside *Giles*, the rule is that a shareholder is barred from recovering from a wrongdoer a loss caused by a breach of duty owed to the shareholder where such loss is reflective of loss caused to the company[47] by a breach of duty owed to the company. The rule, of course, applies to all shareholders including those holding shares as trustees for beneficiaries. It will also apply where the beneficiaries sue the wrongdoer in right of the trustee"s cause of action as shareholder, joining the trustee as co-defendant in the special circumstances where such derivative action is permitted (as explored in heading 5 below).

Losses in underlying companies owned by trustees

Take the case where a trustee failed to supervise the directors of the company wholly owned by it, failed to ensure it had an adequate supply of information as to the company"s affairs and grossly failed to take action to prevent improper or speculative investment by the company or dishonest conduct of the directors. Assume that the trustee is liable to the beneficiaries for breach of trust, no clause in the trust deed being effective to protect it. Assume also that the company can sue its

[46] [2009] EWCA Civ 830.
[47] If not reflective of the company's loss the shareholder's loss can be recovered eg where the defendant's deceit caused the shareholder as controlling shareholder to guarantee loans to the company undertaken as a result of the deceit: *Gould v Vaggelas* (1985) 157 CLR 215, *Prudential Assurance Co Ltd v Newman Industries Ltd* [1982] Ch 204 at 222-224.

directors for loss caused by their breaches of duty to the company and, perhaps in a rare case, the trustee-shareholder can sue the directors for breaches of duty owed to it.

In this last situation where the wrongdoing directors are liable to two claimants it is clear that double recovery needs to be prevented and that, to prevent possible prejudice to the interests of creditors of the company, the company needs to recover the damages in priority to the shareholding trustees. An example of this, but involving secret profits rather than losses, is *Shaker v Al Bedrawi*[48]. The wrongdoer, T, was director of a company to which he was liable to disgorge a secret profit, and was also trustee for B, to whom he would have been liable to a claim for an account of profits except for this being barred under the rules relating to reflective losses or profits, it being immaterial that the causes of action of the company and of B were different.

What, however, of the situation where there is not one wrongdoer liable to two claimants, but one wrongdoer, the trustee, liable to beneficiaries and another wrongdoer, the board of directors, liable to a wholly-owned company of the trustee? In *Freeman v Ansbacher Trustees (Jersey) Ltd*[49], on a strike-out application, it was assumed (1) that a grossly negligent trustee in breach of trust was liable to a discretionary beneficiary to reconstitute the trust fund in respect of the diminution in the value of all the beneficiaries‟ interests in the wholly-owned company shareholding held by the trustee and (2) that the directors of that company were liable to the company for its losses. There is a danger of double recovery in that the beneficiary could recover from the trustee compensation

[48] [2002] EWCA Civ 1452 [2003] 1 Ch 150.

[49] [2010] WTLR 569,2009 JLR 1.

to augment the trust fund by the amount of the diminution in value of the shareholding and then the company could recover damages for its losses from its directors so as to increase the value of the shareholding to what it would have been but for those losses, though subject, if need be, to prior use of the damages for payments to creditors of the company.

To try to cope with these problems created by the reflective loss principle, in *Freeman v Ansbacher Trustees (Jersey) Ltd* Deputy Bailiff Birt considered that the court in its discretion could arguably direct the defendant trustee not to reconstitute the trust fund but to reimburse or re-finance the company, so that it would then no longer have suffered any loss and thus would not be able to bring any claim against its directors. Thus, its creditors would not be prejudiced and there would be no double recovery of losses. He dismissed the strike-out application.

This novel approach, as Birt DB pointed out, has the merit of making it immaterial whether the trustee directly owned investments or owned them through an underlying company. It also means that if the trustee does not take steps for the company to sue the directors, the claimant beneficiaries do not have to vindicate their rights by bringing proceedings to replace the trustee with a trustee who would sue the directors or by suing the trustee for a new breach of trust caused by its refusal to sue the directors. He stated[50] "It would not reflect well on the law or Jersey as a centre for the administration of trusts if beneficiaries had to go through these considerable hoops unless it was absolutely unavoidable. It is of first importance that beneficiaries of a trust whose assets have been

[50] At [97(xiii)].

mismanaged should have a simple and effective remedy whether such assets are held directly by the trustee or through a wholly-owned company."

Birt DB‟s constructive approach remains to be tested in substantive proceedings. The safe approach is for the beneficiaries to request the trustee to arrange for proceedings to be brought in the company‟s name to sue the directors to recover the full losses suffered by the company (or where the directors were also employees of the trustee, as in *Freeman*, to request the trustee to resign due to a conflict of interest and appoint a new trustee to pursue the company‟s claim against its directors). It would be an end of the matter if full losses were recovered for the company either by this action or, if the trustee wrongfully refused to sue so as to create „special circumstances‟, by a derivative action by the beneficiaries in the right of the trustee, joining the trustee as a defendant. To the extent that full losses were not recovered (e.g. due to impecuniosity of the defendant directors) then the beneficiaries could sue the trustee for the diminution in the value of their shareholding.

The position is more straightforward where the trustee is both director and owner of the underlying company or the directors act as its nominees or agents, because if such shareholder-owner of the company authorises the company to enter into transactions prejudicing the company, then the company has no claims against its directors or its owner. The beneficiaries simply sue the trustee to reconstitute the trust fund - or pay them their full net shares if absolutely entitled under a bare trust.

3. Exploiting Jersey (or Guernsey) Limitation Periods for Discretionary Trusts

Freeman v Ansbacher Trustees Jersey Ltd also makes clear an advantage that Jersey law has over trust jurisdictions that have limitation laws based on s 21(3) of the English Limitation Act 1980 or its predecessor, s 19(2) of the Limitation Act 1939.

Under English law, by virtue of s 21(1) of the 1980 Act or s 19(1) of the 1939 Act no limitation period applies to an action by a beneficiary (or trustee) against a fraudulent trustee or to recover from a trustee traceable trust property or trust property previously received by the trustee and converted to his use. By virtue of s 21(3) or 19(2), however, an action by a beneficiary (or new trustee) to recover trust property or in respect of any breach of trust is subject to a six year limitation period or, where there has been deliberate concealment of facts, a period of six years from discovery of the concealment or the time when it could have been discovered with reasonable diligence. Nonetheless, under the proviso to s 21(3) or s 19(2) a right of action does not accrue to a beneficiary *entitled* to a future interest until the interest falls into possession. Moreover, a right of action (eg for reconstitution of the trust fund) does not accrue to an object of a discretionary trust or power (and so a person not *entitled* to a future interest) until he or she becomes a beneficiary having an interest in possession in the trust property affected by a relevant breach, as apparent from *Armitage v Nurse*[51], as explained in *Lemos v Coutts (Cayman) Ltd*[52], and reflecting the position first established in s 8 of the Trustee Act 1888.

[51] [1998] Ch 241 at 261.

[52] (2006) 9 ITELR 616.

Under s 1(1) of the Trusts (Jersey) Law 1984 „"beneficiary" means a person entitled to benefit under a trust or in whose favour a discretion to distribute property held on trust may be exercised‟, so extending to an object of a discretionary trust or power.

While s 57(1) of the 1984 Law is similar to the English s 21(1) or 19(1), s 57(2) lays down a period of *three* years from the delivery of final accounts of the trust to the beneficiary (or the enforcer) or from the date on which the beneficiary (or the enforcer) first has knowledge of the occurrence of a breach of trust, whichever period shall first begin to run. Once these three years expire (or three years expire from the date the claimant ceased to be a minor) a discretionary object‟s right of action is barred.This is dramatically different from the English position where decades may pass after a breach of trust before a discretionary object‟s right of action accrues - and such an object cannot be guilty of laches for sleeping on his rights until those rights arise. It is also noteworthy that under s 57(3A) a breach of trust action against a former trustee (not being a fraudulent trustee etc) must be brought within three years from the date the former trustee ceased to be trustee (not the six years as under English law). Section 76 of the Trusts (Guernsey) Law 2007 is to similar, but less extensive, effect.

It follows that trustees may consider that Jersey (or Guernsey) law better balances the interests of trustees and objects of discretionary trusts or powers so as expressly to choose Jersey (or Guernsey) law to govern a trust as permitted by the UK Recognition of Trusts Act 1986. Indeed, there seems no reason why a trust governed by English law should not take advantage of Article 9 of the Hague Trusts Convention (in force under the 1986 Act) for the "severable aspect" concerning applicable limitation periods expressly to be governed by Jersey (or Guernsey) law. Alternatively, since it appears that provisions of the Limitation Act may be ousted (eg by contract or estoppel by convention: *Revenue & Customs Commissioners v Benchdollar*[53]) one could incorporate as part of a trust governed exclusively by English law detailed provisions in the trust instrument setting out as specific to the English trust the same limitation periods as those provided for under Jersey (or Guernsey) law.

4. *Impact of the EU Succession Regulation*

The Brussels 1 Regulation No. 44/2001 on jurisdiction and recognition of judgments in civil and commercial matters, like the Brussels Convention that it replaced, deliberately excluded matters concerning "wills and succession." These matters are particularly complex and diverse due to common law States having a distinction between administration of estates and succession to estates that civil law States do not have, with a common law estate passing to the deceased"s personal representatives and a civil law patrimony to the deceased"s heirs subject to obligations to any legatees. The *lex successionis* varies from State to State. It can depend upon habitual residence or nationality or „domicile" (in the common law sense) of the deceased at death or at the date of executing a will or codicil, though immovables may be governed by their *lex situs*.

Moreover, in common law States the *lex successionis* governs only property comprised in the deceased"s estate at death, so excluding property earlier given away by the deceased in *inter vivos*

[53] 2009] EWHC 1310 (Ch) [2010] 1 All ER 174 at [46].

dispositions such as gifts to trustees of family or charitable trusts that are unimpeachable under the *lex situs*[54]. In civil law States these gifts made within varying periods before the death of the deceased are subject to the *lex successionis* so as to be made available under "claw-back" rules to help satisfy the forced heirs‟ claims to indefeasible or reserved shares of the deceased‟s patrimony, notionally treated as including property gifted away before death[55]. Thus donees are forced to return the value of their gifts to make up the amount of the forced heirship shares.

The Succession Regulation will provide for simplified harmonised rules as to the *lex successionis* so as to make it possible for providing common rules as to jurisdiction and recognition of judgments. A draft Regulation was produced by the European Commission in October 2009 with any decision of a State to "opt in" and so be bound by the finalised Regulation to be made by 22nd January, 2010.

The UK decided not to "opt in" but to participate as an observer with speaking rights but no voting rights in finalising the Regulation.

[54] In exceptionally rare cases gifts made fewer than 6 years before death with the intention of defeating a claim under the Inheritance (Provision for Family and Dependants) Act 1975 can be set aside to the extent needed to satisfy such a claim, though special protection is then afforded to trustee-donees under s 13 of the 1975 Act.

[55] See Prof Paisley's "Comparative Analysis of the Laws of the Member States on the Issue of Clawback' in Annexe 1 to Ministry of Justice's European Commission Proposal on Succession and Wills www.justice.gov.uk/consultations/ec-succession-wills

Major issues preventing an "opt in" were

(i) the connecting factor to fix the *lex successionis* is to be the deceased‟s habitual residence at death unless there had been a testamentary choice of nationality at the time of executing the testament: but this was criticised as no definition of "habitual residence" is provided, while no choice of law of habitual residence at the time of the testament is permitted;

(ii) forced heirship clawback rules of the *lex successionis* are to prevail over the *lex situs* that currently governs UK *inter vivos* transfers and determines what falls outside the deceased‟s estate governed by the *lex successionis*: this was wholly unacceptable;

(iii) jurisdiction is to be governed not by the *lex successionis* but by the deceased‟s last habitual residence which, of course, will not be the *lex successionis* if the deceased has chosen the State of his nationality which is different from that of his last habitual residence, though it is to be possible for the courts of the last habitual residence to transfer jurisdiction to those of the *lex successionis*: the *lex successionis* should have jurisdiction from the outset;

(iv) authentic instruments of notaries are to be recognised and enforced unless contrary to public policy, but this gives too great a force to them: they should only have status as evidence;

(v) similarly, the proposed European Certificate of Succession should not be automatically recognised, but should only provide non-conclusive evidence of the salient aspects of a succession[56].

Depending upon the unlikely event of most UK concerns being satisfactorily dealt with in the Regulation as finalised by the EU Council and enacted by the European Parliament (time-tabled for November 2010), the UK could subsequently sign up to the Regulation. The Regulation needs to be adopted with qualified majority voting in the Council and full co-legislative powers of the Parliament, as made clear on 4 June 2010 when the Council approved a set of six political guidelines:

(A) a comprehensive regulation on applicable law, jurisdiction & recognition and enforcement of judgments with a European Certificate of Succession;

(B) one single authority – a court or a notary – should (C) apply one *lex successionis* to the whole estate, movable or immovable, wherever located;

(D) the law of the jurisdiction of the deceased‟s habitual residence at death should be the *lex successionis* and (E) should have jurisdiction (with subsidiary power to refer to another relevant jurisdiction), taking account of (F) a limited choice of the *lex successionis* eg the deceased‟s nationality at the date of the will.

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[56] Further see House of Lords, European Union Committee, 6th Report of Session 2009-10, The EU's Regulation on Succession, Report with Evidence, HL Paper 75.

Even if the UK cannot accept the enacted Regulation, it may well enact domestic legislation to bring it closer into line with the law in the Regulation e.g. have one *lex successionis* for movables and immovables, being the law of habitual residence (as defined) at death or the time of executing the will or codicil or the law of nationality at the time of executing the will or codicil, but preserving the supremacy of the *lex situs* for the validity of *inter vivos* dispositions; recognise authentic instruments and European Certificates of Succession as high quality evidence requiring clear evidence of rebuttal if to be rebutted.

5. **Derivative claims of beneficiaries**

Because a trust fund has no legal personality it cannot sue third parties for losses or to account for profits. Instead, it is the trustees who sue, or are sued by, third parties, and the trustees are personally liable to the extent of their own patrimonies, though having a right of recourse to the trust fund to pay, or be reimbursed, for costs and expenses, so long as not having acted in breach of trust. Such right of recourse has priority over the interests of the beneficiaries, and creditors of the trustee *qua* trustee can take advantage of such right by way of subrogation eg if the trustee is insolvent[57].

What happens if the trustees decide not to sue a third party? One option is for the beneficiaries to argue that this failure to sue amounts to a breach of trust entitling them on their personal account

[57] See Underhill & Hayton, *Law of Trusts & Trustees*, 17th ed Art 83.

to sue the trustees and require them to restore the trust fund to the value it would have had but for their breach of trust.

Alternatively, "in special circumstances" the beneficiaries can take advantage of the trustees" right of action and directly sue the third party, joining the trustees, so that they will be bound by the judgment and able to receive the money augmenting the value of the trust fund, such fund then being available, if need be, to satisfy creditors" claims against the trustees *qua* trustees that have priority over the beneficiaries" interests in the net fund.

As stated by Lord Collins in *Roberts v Gill*:[58]

"The special circumstances which were identified in the earliest authorities as justifying a beneficiary"s action were fraud on the part of the trustee, or collusion between the trustee and the third party, or the insolvency of the trustee, but it has always been clear that these are merely examples of special circumstances, and that the underlying question is whether the circumstances are sufficiently special to make it just for the beneficiary to have the remedy".

Lord Collins endorsed Lord Templeman"s statement in *Hayim v Citibank NA*[59] "that a beneficiary has no cause of action against a third party save in special circumstances which embrace a failure, excusable or inexcusable, by the trustees in the performance of the duty owed by the trustees to

[58] [2010 UKSC 22 at [46].
[59] [1987] AC 730 at 748.

the beneficiary to protect the trust estate or to protect the interests of the beneficiary in the trust estate."

Thus, it will normally be just for a beneficiary to be able to sue the third party where the trustees" failure to sue amounts to a breach of trust (e.g. in depriving the beneficiaries of an augmentation of the trust fund). It will not, however, be a breach of trust where, taking account of the value of the trust fund, the uncertainty of winning a proposed law suit against a third party and the amount claimable in that suit, the trustees in good faith decide not to pursue the suit. Moreover, a beneficiary will not be permitted to bring a derivative action merely because he will be legally aided so the trustees decide not to proceed and let him proceed[60].

In *Roberts v Gill* the Supreme Court had to consider the position of a residuary legatee seeking to bring a derivative action on behalf of the testator"s personal representative against solicitors alleged to have been negligent in letting the claimant"s brother as original administrator defraud the residuary legatees (and the Revenue) in 1995-1997. In 2000, at the claimant"s instigation, the brother was replaced as administrator not by the claimant but by his solicitor, S. In November 2002, the claimant brought a personal action for negligence against the solicitors for breach of a duty of care owed to him in 1995-1997 as residuary legatee. In March 2003 the defendant solicitors wrote to the claimant that he had no personal claim because no duty of care is recognised between

[60] *Roberts v Gill* [2008] EWCA Civ 803 at [43].

a solicitor instructed by a PR and a legatee. By the end of 2003 any claim by S as administrator was statute-barred.

In August 2006 the claimant applied to amend the proceedings outside the limitation period so that he could continue them in his name but in right of the administrator as a derivative action arising out of the same or substantially the same circumstances as the existing personal claim. Leave so to amend was problematical, especially when the administrator would need to be added as a defendant. There were two issues. Were there special circumstances to permit a derivative action to be brought and, if there were, should leave to amend out of time be granted? The trial judge and Pill LJ thought there were no special circumstances but Arden LJ (with whom Patten J concurred) thought there were, though they refused to grant leave out of time.

The Supreme Court unanimously held that the trial judge had a wide latitude in evaluating what were special circumstances and there were no grounds for interfering with his view (after he had considered 18 enumerated circumstances) that there were no special circumstances to justify permitting the claimant to bring a derivative action, so the proceedings could not be amended: Pill LJ was right.

It seems the most significant circumstances involved the claimant"s own conduct in not himself replacing his brother in 2000 as administrator or, after receipt of the defendant solicitors" letter telling him he had no personal claim, not procuring from the new administrator, S, the vesting of the estate"s cause of action against the solicitors and it being too late to seek such after 2003 when the action had become statutebarred. Moreover, the claimant was not alleging that S"s failure to sue the solicitors was open to criticism or that S would not have been prepared, if asked, to vest the estate"s cause of action in the claimant. The claimant had had plenty of opportunity before expiry of the limitation period to bring the derivative action he now sought to take. As ever, face up to problems without delay as soon as they arise.

There were also the following complications: there was another residuary legatee, the Revenue was a major creditor, and the claimant was legally aided so that costs could not be obtained against him if he lost, though query the position then of the joined administrator when the estate had no assets other than the projected right of action.

Note that, as stated in Lewin on Trusts, 18th edition, paragraph 43-05, endorsed by Arden LJ in Court of Appeal in *Roberts*[61], "If there is a genuine dispute between the beneficiaries as to whether an action against a third party would be in the interests of the trust, then an administration action should be brought so that the matter might be determined as between the beneficiaries before proceedings are commenced in the name of any of them or in the name of the trustee."

Because no derivative action could be permitted the Supreme Court did not have to decide whether, if permissible, the amendment should be allowed, especially when it would require a new party, the administrator, S, to be added as a defendant outside the limitation period expiring at the end of 2003. Diverse views were expressed by the Justices.

[61] [2008] EWCA Civ 803 [2008] WTLR 1429 at [14].

6. Trustees' costs problems defending Proceeds of Crime Act 2002 claims

Where the Serious Organised Crime Agency (SOCA) has obtained an interim receiving order against what it considers to be "recoverable property" derived from unlawful conduct, a defendant may, under section 252 of the Proceeds of Crime Act 2002 ("POCA"), seek an exclusion order to exclude (or free) from the freezing order assets sufficient to cover the defendant"s reasonable legal expenses.

The court has a balancing discretion to exercise, taking account of the desirability of a defendant being legally represented and the need to ensure, so far as is practicable, that the right of SOCA to recover recoverable property is not unduly prejudiced: s. 252 (4A) and s. 252 (6).

The Proceeds of Crime Act 2002 (Legal Expenses in Civil Recovery Proceedings) Regulations 2005, SI 2005 No.3382, provide detailed guidance and are supplemented by a CPR Practice Direction – Civil Recovery Proceedings. Para 7A.4 thereof provides "The court (1) will not make an exclusion for the purpose of enabling a person to meet his reasonable legal costs if it is satisfied that the person has property to which the interim receiving order does not apply from which he may meet those costs." Henderson J in *SOCA v Szepietowski*[62] held that, under the self-contained exclusion order regime, if a trustee has free property (e.g. equity in houses solely or jointly owned by him which could be used as security for loans to cover legal costs) then he cannot obtain an exclusion order and so must fund the defence personally or abandon the defence; after all, a trustee

[62] [2009] EWHC 344 (Ch).

as a matter of trust law is not bound to institute or defend proceedings if there are no trust funds available for the purpose[63]. Of course, if the trustee wins he can recover costs from SOCA and also rely on his right to an indemnity out of the trust fund which, *ex hypothesi*, would have been held not to be recoverable property. Thus, there would only have been temporary funding out of the trustee"s own pocket if he had won.

If the trustee fails, the court still has discretion under POCA s 266 (8A)[64] to provide for payment out of the recovered fund of "reasonable legal expenses that a person has reasonably incurred in respect of recovery proceedings." Indeed, there is a discretion to order costs on an indemnity basis under Regulation 16(2(a) instead of the standard basis. Only if the trustee had acted unreasonably in defending the proceedings would the court be likely to refuse to make a costs order in the trustee"s favour[65].

Henderson J commented[66] "If the statutory regime encourages trustees to ask probing questions about the origins of the trust fund before accepting office, and to exercise due diligence, that can in my judgment only be a good thing".

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[63] Ibid at [58].

[64] Inserted by Serious Organised Crime and Police Act 2005 s 109, Sched 6 para 15.
[65] At [63].
[66] At [64].

7. *Problems where beneficiaries are entitled to undivided shares of the whole income of the fund as opposed to the whole income of a particular share of the fund*

Sutton v England[67] brings out the need to be aware of technical or practical problems arising out of Goff LJ stating in *Re Freeston's Charity*[68] "an interest in half the income of an undivided fund is quite different from the whole income of a divided half of that fund", so that if interests in income are desired by a settlor or testator it is better to provide for interests in the income of specific divided shares of a trust fund. If, unfortunately, the trust instrument provides for shares of income of an undivided trust fund one cannot rely upon s 57 of the Trustee Act 1925 to remedy this; recourse can only be had to the Variation of Trusts Act 1958 requiring the consent of all beneficiaries of full capacity.

Take a trust where capital on the death of the last surviving issue of three brothers, A, B, C, is to be divided between their issue alive at the end of the perpetuity period *per stirpes* in the proportions 50%, 30%, 20% respectively.

Until that last death income is to be paid in those proportions to the three brothers until their deaths; thereafter, those proportions of income go to their children *per stirpes* equally, with successor generations taking on prior generations dying and cross-accruer clauses on a *stirps* dying out.

Problems arise when capital has to bear tax on the death of a life tenant entitled to a fraction of the whole income of the find since there is no particular restricted fraction of the capital to bear

[67] [2009] EWHC 3270 (Ch).

[68] [1978] 1 WLR 741 at 751.

the burden of inheritance tax – unlike the case where B is entitled to all income of half the fund when IHT comes out of that half so as to diminish future income of B"s successor as life tenant in that half.

To deal with this problem two techniques are possible

(i) The proportionate approach

As from the date the tax was paid out of capital the amount of tax is treated as reducing the capital ultimately to be distributed as the share of the *stirps* of the deceased life tenant. This reduces the share of capital of the *stirps* and this share is applied to distributing income from shares of capital.

(ii) The arithmetical hotchpot approach

The tax paid out of capital is treated as an advance in anticipation of the ultimate division of capital. When that time comes the advances are added back, the division is done, and the advances are then debited from each relevant share before it is paid. Where income is concerned, beneficiaries of the relevant *stirps* are treated as if they had received 4% interest on the notional advance. This notional income is added to the actual income and the specified fractional shares are applied to that aggregated sum but the relevant stirpital beneficiaries are treated as having already been paid the notional interest before receiving the balance.

In *Sutton v England* the trustees of a 1940 Trust of undivided shares in the whole income of a fund had applied the arithmetical approach throughout the Trust"s history. They sought (1) a direction that they should take no steps to revisit this approach adopted by them and their predecessors and (2) a direction that henceforth they might determine in their absolute discretion how Inheritance Tax should be borne and reflected as between the stirpital beneficiaries.

Mann J refused the second direction as the issue seemed a matter of mixed law and fact and discretion, so it would be wrong in principle to give the trustees an absolute discretion to decide the issue. If he was wrong on that, so it was a matter of discretion for the trustees to do what was fair, then either the proposed direction added nothing or it gave them an even wider discretion, which would be inappropriate.

Mann J did make the first direction which all counsel favoured. This "let sleeping dogs lie" without any need to go into the complex seemingly uncertain position as to which of the two approaches was the proper one or whether either could be used within the reasonable discretion of the trustees. He did, however, emphasise that the trustees" past conduct was not "immune from scrutiny for all purposes and for all time" since "it may be that in the future [e.g. on ultimate division of the capital] a consideration of what should be done might require a revisiting of the past."[69]

Could the problems be avoided in the future by using s. 57 to insert a power of appropriation that could be exercised to convert the specified shares in the income of the whole fund to rights to the whole income of specified parts of the fund, especially when one *stirps* was resident in the USA so that a distinct sub-trust of a specified part with US resident trustees would avoid serious double taxation problems?

[69] At [20].

"No" held Mann J regretfully even though this would be most "expedient" as required by s. 57, because[70] the section cannot be used to "create a different set of beneficial interests, qualitatively speaking, to those which currently exist." The whole point of inserting the power of appropriation was for partitioning the fund into trusts of divided shares of capital and income for each of the *stirps* in place of a trust of the whole capital and income in undivided shares for all the *stirpes*. So to alter the beneficial interests would require an application under the Variation of Trusts Act 1958 as apparent from *Re Freeston's Charity*.

Interestingly, Mann J accepted the decision of Smellie CJ in *MEP v Rothschild Trust Cayman Limited*[71] where the equivalent of s.57 was held to authorise the court inserting a power to apportion a trust fund into three funds where the beneficial interests in those funds were to be exactly the same as in the original unpartitioned fund, the differences in the sub-funds being as to administrative matters relating to the composition and powers of Management Committees and the appointment or removal of trustees.

Mann J did, however, use s. 57 to confer additional administrative powers to bring the trustees" 1940 powers into line with modern trusts, though rejecting the following requested power:

"The Trustees may pay tax liabilities (and interest on such tax) in relation to the trusts under this settlement even though such liabilities are not enforceable against the Trustees."

[70] At [42].

[71] No 128 of 2009,20 October, 2009.

It was argued that the Revenue authority of a foreign jurisdiction might regard the trustees as liable for tax but be unable to enforce the liability in the trustees‟ home jurisdiction, though paying the tax might be necessary if a trustee wished to visit the foreign jurisdiction and not be detained there until paying the tax. Mann J did not think the trustees‟ personal travel plans of a business or holiday nature should lead to a liability being imposed on the trust fund which it would not otherwise be forced to bear.

This approach of Mann J indicates that if such a tax payment provision is to be expressly inserted into a trust deed one needs to add a final clause empowering payment to be made "even if such a payment is in the best interests of the trustees rather than the best interests of the beneficiaries". Alternatively, one could restrict the provision in some fashion eg by adding "only where such liabilities can be enforced against some beneficiaries or against assets directly or indirectly owned by the trustees."

The lesson to be learned from *Sutton v England* where shares of income and capital are to be conferred on beneficiaries successively within a family *stirps* is to divide the capital, and thus the income, into particular shares rather than leaving the capital as an undivided fund in the income of which each *stirps* has a particular share.