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RUDGE REVENUE REVIEW

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INDEX

‘SECOND THOUGHTS’

AN EAGERLY AWAITED DECISION

The Supreme Court’s judgement in the joined cases of *Futter and another (Appellants) v HMRC, Pitt and another (Appellants) v HMRC*[1] was given on 9th May 2013. The judgement was eagerly awaited as it was expected to give an authoritative view of the *Hastings-Bass* Principle (the ‘Principle’) which had been radically revised by the Court of Appeal’s decision in these joined cases in 2011. No less than seven law lords sat on the case including the President of the Supreme Court, Lord Neuberger. The decision was unanimous and largely confirmed the Court of Appeal’s decision with Lord Walker giving the only substantial judgment and the other six law lords simply agreeing with it. The cases involved applications by trustees (Futter) and by a Mental Health Act Receiver (Pitt) for certain transactions to be set aside under the Principle and, in the case of Pitt, on the alternative ground of Mistake. This article considers the decisions only in relation to the Principle and not in respect of Mistake.

THE PRINCIPLE BEFORE *FUTTER & PITT* CA

Before the decision in *Futter & Pitt CA* the Principle was thought to be based on the following statement by Lord Justice Buckley in the case of *Re Hastings-Bass (deceased)*:-[2]

> ‘…where by the terms of a trust … a trustee is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action notwithstanding that it does not have the full effect which he intended, unless (1) what he has achieved is unauthorised by the power conferred on him, or (2) it is clear that he would not have acted as he did (a) had he not taken into account considerations which he should not have taken into account, or (b) had he not failed to take into account considerations which he ought to have taken into account’.[3]

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1 *Futter and another (Appellants) v The Commissioners for Her Majesty’s Revenue & Customs (Respondent); Pitt and another (Appellants) v The Commissioners for Her Majesty’s Revenue & Customs (Respondent)* [2013] UKSC 26. In this Article the Supreme Court’s decision is referred to as ‘*Futter & Pitt SC*’. In the Court of Appeal the joined cases were designated *Pitt and another v Holt and another, Futter and another v Futter and others* [2011] EWCA Civ 197. In this Article the joined cases are called ‘*Futter & Pitt*’ and the Court of Appeal’s decision is referred to as ‘*Futter & Pitt CA*’. Where the Supreme Court or the Court of Appeal referred to the individual cases they are referred to simply as *Futter* or *Pitt* as the case may be. The cases were not joined in the High Court and were designated *Futter and another v Futter and others; Re Futter (No 3 and No 5) Life Interest Settlements* [2010] EWHC 449 (Ch) and *Pitt and another v Holt and another* [2010] EWHC 45 (Ch). In this Article, the High Court decisions in the cases are called ‘*Futter ChD*’ and ‘*Pitt ChD*’ respectively

2 *Re Hastings-Bass (deceased); Hastings and others v Inland Revenue Commissioners* [1974] STC 211

3 *Re Hastings-Bass (deceased); Hastings and others v Inland Revenue Commissioners* [1974] STC 211 at page 221

This negative formulation ('the court should not interfere … unless') was subsequently expressed in positive terms in *Mettoy Pension Trustees Limited v Evans and others*:-[4]

> 'where a trustee acts under a discretion given to him by the terms of the trust, the court will interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account.'[5]

In the case of *Sieff v Fox*,[6] Lord Justice Lloyd, who later gave the leading judgment in the *Futter & Pitt CA*, summarised what he called 'the *Mettoy* formulation[7] of the [*Hastings-Bass*] Principle' as follows:-

> 'Where a trustee acts under a discretion given to him by the terms of the trust, but the effect of the exercise is different from that which he intended, the court will interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account, or taken into account considerations which he ought not to have taken into account.'[8]

The positive version of the rule formulated in *Mettoy* was applied by the Courts in a number of cases including *Green v Cobham,*[9] *Abacus Trust Company (Isle of Man) Limited v NSPCC,*[10] *Burrell v Burrell,*[11] *Sieff v Fox,*[12] *Jiggens v Low*[13] and *Independent Trustees Services Ltd v Hope*.[14] Some of these cases have involved applications by trustees in respect of actions which they have undertaken which have turned out to have had unexpectedly adverse tax consequences. They include *Green v Cobham, Abacus Trust Company*, *Burrell v Burrell*, *Sieff v Fox* and *Jiggins v Low*.

HMRC'S HOSTILITY TO THE PRINCIPLE

An article in HMRC's *Tax Bulletin*[15] expressed HMRC's:-

> 'concern … that the principle as currently formulated is too wide in its scope'.

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4 *Mettoy Pension Trustees Limited v Evans and others* [1991] 2 All ER 513

5 *Mettoy Pension Trustees Limited v Evans and others* [1991] 2 All ER 513 at page 552 and 553. In fact, this was Lord Justice Buckley's summary of the various formulations of the Principle advanced by the Counsel for the defendants but it appears Lord Justice Buckley considered it a correct formulation. See page 555

6 *Sieff and others v Fox* [2005] EWHC 1312 (Ch)

7 *Sieff and others v Fox* [2005] EWHC 1312 (Ch) at para 49

8 *Sieff and others v Fox* [2005] EWHC 1312 (Ch) at para 49

9 *Green and others v Cobham and others* [2000] WTLR 1101

10 *Abacus Trust Company (Isle of Man) Limited v NSPCC* ChD [2001] STC 1344

11 *Burrell and another v Burrell and others* ChD [2005] STC 569

12 *Sieff and others v Fox* [2005] EWHC 1312 (Ch)

13 *Jiggens and another v Low and another* [2010] EWHC 1566 (Ch)

14 *Independent Trustees Services Ltd v Hope and others* [2009] EWHC 2810 (Ch)

15 *Tax Bulletin*, Issue 83, 23rd June 2006

The *Tax Bulletin* article went on to say:-

> 'HMRC will now give active consideration to participating in future cases where large amounts of tax are at stake and/or where it is felt that we could make a useful contribution to the elucidation and development of the principle. We will be particularly ready to intervene in cases where there would otherwise be no party in whose interest it would be to argue against the application of the principle.'

The article then went on to set out seven ways in which HMRC thought that the Principle should be restricted.

It is surprising that the question of whether it is proper for a Government Department, the function of which is to administer the law and to advise Government on ways in which the law might be changed to advance the Government's aims, to become a partisan in attempting to influence the Court's elucidation of the scope of a legal principle has not been more widely commented upon.

JUDICIAL HOSTILITY

However that may be, HMRC's concern was shared by some members of the judiciary. In *Breadner and others v Granville-Grossman and others*,[16] Mr Justice Park said:-

> 'The principle is still at an early stage of development, and the limits to it have not been established. There must surely be some limits. It cannot be right, that whenever trustees do something which they later regret and think that they ought not to have done, they can say that they never did it in the first place.'

In the High Court, in *Futter ChD* Mr Justice Norris, finding for the trustees on the basis that the Principle applied, commented:-

> 'When the Court of Appeal fashioned for the trustees of the 1947 settlement upon Captain Hastings-Bass a stout shield against an attack upon the validity of their decisions by the Inland Revenue, the members of the court cannot have supposed that they were creating for such trustees a powerful weapon enabling them to attack their own decisions in the face of objections by the Inland Revenue. But that, of course, is what has occurred …'[17]

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[16] *Breadner and others v Granville-Grossman and others* ChD [2000] 4 All ER 705 at para 61

[17] *Futter ChD para 1.* Mr Norris' comments point to a pleasing irony. In *Re Hastings-Bass* itself, it was the Inland Revenue which argued that an advancement by trustees should be treated as void because the advance which they thought they were making was different from the advance which they actually made (part at least of the advance having failed because it breached the rule against perpetuities) and therefore the trustees, not understanding the nature of the advance which they were making, could not have taken into account all relevant circumstances and could not, therefore, have given due consideration and weight to the benefit to be conferred on the person advanced. It was therefore the Inland Revenue, who argued that, what became known as the *Hastings-Bass* Principle, applied

Lord Neuberger, speaking to the Chancery Bar Association in 2009, described the Principle as a 'magical morning-after pill' for trustees suffering post-transaction remorse'.

In *Futter ChD* Mr Justice Norris said, less than even-handedly, that:-

> 'The trustees wish to take advantage of [their] failure to perform their duties in order to enable the beneficiaries to avoid paying the tax liability consequent upon the trustees' decision.'[18]

Lord Walker in the Supreme Court in *Futter & Pitt SC* said:-

> 'There must be some suspicion that reliance on the *Hastings-Bass* rule has come to be seen as something of a soft option …'[19]

The Principle on which the rule is based, however, is not to allow trustees to escape the consequences of their failure to act properly but rather to protect beneficiaries from the harm done by the trustees. Beneficiaries do not 'avoid paying the tax liability consequent upon the trustees' decision' because where the Principle applies so that the decision is either void or avoided, no transaction has taken place which attracts a tax liability.

Nonetheless in *Futter & Pitt CA,* Lord Justice Longmore described the appeals as:-

> ' … examples of that comparatively rare instance of the law taking a seriously wrong turn, of that wrong turn being not infrequently acted on over a twenty-year period but this court being able to reverse that error and put the law back on the right course.'[20]

The Supreme Court did not expressly say that the law had taken a wrong turn in its development of the *Hastings-Bass* Principle but it is clear that it was determined to place strong restraints upon its scope.

THE SUPREME COURT'S DECISION ON THE PRINCIPLE

The *Hastings-Bass* Principle is not found in *Hastings-Bass*

One of the oddities of the decisions of both the Court of Appeal and the Supreme Court is that they found that the *Hastings-Bass* Principle was not actually founded upon the decision in *Re Hastings-Bass.*

The Supreme Court agreed with Lord Justice Lloyd's assertion in the Court of Appeal that Lord Justice Buckley's summary of the Principle which is quoted above was not actually the ratio on which his decision was made. That is, they found that Lord Buckley did not understand the ratio of his own decision.

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18 *Futter ChD* para 2
19 *Futter & Pitt SC* para 7
20 *Futter & Pitt CA* para 227

> ‘Lloyd LJ did not accept that as the true ratio. He thought that the Court of Appeal had already decided the case on the ground that the advancement, so far as not struck down by the rule against perpetuities, must stand unless it could not, in that attenuated form, reasonably be regarded as beneficial to the advancee.’[21]

Lord Justice Lloyd considered that he was bound by the decision in *Re Hastings-Bass* but not by any of the other decisions on the Principle thereafter because they were all decisions of the High Court.[22] The Supreme Court, of course, was not bound by the *Re Hastings-Bass* decision but it appeared anxious not to overrule it. It appears that the reason why both the Court of Appeal and the Supreme Court thought it important not to regard Lord Justice Buckley’s summary of the Principle as being the ratio of his decision in *Re Hastings-Bass* is because it includes, within the one principle, acts which are ‘unauthorised by the power conferred on’ the trustee and acts based on inadequate or improper consideration. In the Supreme Court, Lord Walker characterised these two categories as ‘excessive execution’ and ‘inadequate consideration’. It is clear from authority that acts of excessive execution are void.[23] If both acts of excessive execution and acts of inadequate consideration fall within the Principle, it is difficult to see why the latter should only be voidable if the former are void and, as we shall see, the Supreme Court was determined that acts falling within the Principle should be voidable rather than void.

The decisions of the Court of Appeal (although using different terminology) and of the Supreme Court, therefore, depended upon making a clear distinction between the categories of excessive execution and inadequate consideration. This distinction was, perhaps, expressed most forcefully by Lord Justice Mummery in his short concurring judgment in *Futter & Pitt CA*:-

> ‘First, there is a fundamental distinction between, on the one hand, the *existence* and *extent* of a fiduciary power to make a disposition and, on the other hand, the *manner of exercise* of that power. In the case of a disposition to a non-object, the power does not exist. The purported disposition has no legal effect. It is void as against the whole world. If, however, the power to make the disposition exists, but there is a flaw in the manner in which the discretion has been exercised, the disposition will be valid, unless and until set aside as between the parties by order of the court.
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> Secondly, a defect in the manner of making an intra vires decision to exercise a fiduciary power is not, and should not be treated as if it were, an excess of the power. The exercise of the discretion must, of course, be properly informed and considered. The discretion must be performed in an honest, fair and responsible manner, but those requirements of the way that a decision to exercise a discretion is made are not a sufficient basis for implying a legal limitation on the four corners of the power.’[24]

[21] *Futter & Pitt SC* para 24
[22] *Futter & Pitt CA* para 5
[23] *Futter & Pitt CA* para 93, *Futter & Pitt SC* paras 58-59
[24] *Futter & Pitt CA* paras 233-234

Lord Justice Mummery asserts his distinction powerfully but it might be argued that a trust power is not simply a power to do the thing expressly authorised by it but a power to do the thing expressly authorised by it after making proper consideration. The need to make proper consideration would then be a limitation on the power rather than a duty to which the trustee is subject in exercising it. If that were the case, Lord Walker's distinction between excessive execution and inadequate consideration would be blurred.

Both Lord Justice Lloyd in the Court of Appeal and Lord Walker in the Supreme Court considered the application of the distinction between excessive execution and inadequate consideration to fraudulent appointments, which are appointments ostensibly within the scope of a power but made for an improper purpose. That would seem to be a situation where, in exercising a power, trustees take into account matters which they should not (inadequate consideration) rather than being an action which is outside the express scope of the power (excessive execution). The difficulty for the Court was that *Cloutte v Storey*[25] is a longstanding Court of Appeal authority that a fraudulent appointment is void rather than voidable, and so, on the face of it, inconsistent with the hard distinction between excessive execution and inadequate consideration made by Lord Walker and, using different terminology, by Lord Justice Lloyd and Lord Justice Mummery.

Lord Walker did not succeed in harmonising *Cloutte v Storey* with his decision. He contented himself with referring to Mr Justice Lightman's comment in *Abacus* that the judgment of the Court of Appeal in *Cloutte* is 'problematic' and commenting:-

> 'The decision in *Cloutte v Storey* may have to be revisited one day. For present purposes it is sufficient to note that a fraudulent appointment (that is, one shown to have been made for a positively improper purpose) may need a separate pigeon-hole somewhere between the categories of excessive execution and inadequate deliberation.'[26]

The passage that Lord Justice Lloyd identified as the true ratio of the decision in *Re Hastings-Bass*, which concerned the issue of what Lord Walker called excessive execution, related to the fourth of the six arguments advanced by Counsel for the Revenue in that case. One of the other arguments advanced by the Revenue was that:-

> '… the statutory power of advancement confers a fiduciary discretion which can only be properly exercised after giving due consideration to all relevant factors and, in particular, the benefit proposed to be conferred on the person advanced …'[27]

That is clearly an argument based upon inadequate consideration.. To decide on its validity Lord Justice Buckley needed to consider the circumstances in which the Court would intervene where the Trustees had given inadequate consideration to an issue. As he found the Revenue wrong on the Fourth Argument, concerning

25 *Cloutte v Storey* [1911] 1 Ch 18, 80 LJ Ch 193, 103 LT 617
26 *Futter & Pitt SC* para 62
27 *Re Hastings-Bass (deceased); Hastings and others v Inland Revenue Commissioners* [1974] STC 211 at p.216

excessive execution, in order to reach a decision on the application he needed to consider the Revenue's argument on inadequate consideration.

It is not immediately obvious, therefore, why Lord Justice Lloyd had concluded in the Court of Appeal:-

> 'I do not regard Buckley LJ's summary … as being part of the ratio. That may be a convenient summary of what has gone before, it does not appear to be intended to displace or supersede what had already been said.'[28]

or why Lord Walker concluded:-

> 'On this analysis, limb (1) of Buckley LJ's statement of principle covers the whole ground, and limb (2) adds nothing.'[29]

Be that as it may, because Lord Walker decided that:-

> 'The decision of the Court of Appeal in *Re Hastings-Bass* … can be seen, on analysis, to be concerned with a different category of the techniques by which trust law controls the exercise of fiduciary powers. That decision is concerned with the scope of the power itself, rather than with the nature of the decision-making process which led to its being exercised in a particular way …'[30]

he considered that:-

> 'The rule [that is, the Principle] would be more aptly called "the rule in *Mettoy*", … but the misnomer is by now so familiar that it is best to continue to use it, inapposite though it is.'[31]

Lord Walker therefore agreed with Lord Justice Lloyd's conclusion in the Court of Appeal that the positive formulation of the rule in *Mettoy* was based on a misunderstanding of *Re Hastings-Bass*:-

> 'I respectfully agree with Lloyd LJ's view that the basis on which *Mettoy* was decided cannot be found in the reasoning which led to the decision in *Hastings-Bass*. It can claim to be an application of Buckley LJ's summary statement of principle, but only if that statement is taken out of context and in isolation from the earlier part of the judgment.'[32]

One might think that having found that in *Mettoy* the High Court had misunderstood the authority on which it had based its formulation of the Principle, the decision was *per incuriam* and would simply be overruled. Indeed, Lord Justice Lloyd did conclude in the Court of Appeal that:-

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[28] *Futter & Pitt CA* para 65
[29] *Futter & Pitt SC* para 25
[30] *Futter & Pitt SC* para 1
[31] *Futter & Pitt SC* para 1
[32] *Futter & Pitt SC* para 32

> 'The principle promulgated first by Warner J in the *Mettoy Pension Trustees* case …, developed thereafter, and set out by myself in my judgment in *Sieff's* case … is not correct.'[33]

Instead of simply deciding that the Principle had arisen under a mistake and did not exist, however, both the Court of Appeal and the Supreme Court set out a corrected view of the nature of the Principle.[34] In doing so they considered a number of issues which had been matters of uncertainty even when it had been thought that *Mettoy* was a correct statement of the *Hastings-Bass* Principle.

Breach of Duty

It will be seen that the formulations of the Principle in *Re Hastings-Bass, Mettoy* and *Sieff* all require there to be either a failure to take account of something or the taking account of something of which account should not have been taken. In *Abacus Trust Company (Isle of Man) Ltd v Barr*[35] Mr Justice Lightman held that a breach of duty on the part of the trustees is essential to the application of the Principle.[36] In *Sieff*, on the other hand, Lord Justice Lloyd had concluded that the Principle was not restricted to cases where there was a breach of duty by the trustees.[37] By the time that he gave his leading judgment in *Futter & Pitt CA* Lord Justice Lloyd had changed his mind on this issue and, in the Supreme Court, Lord Walker said:-

> 'In my view Lightman J was right to hold that for the rule to apply the inadequate deliberation on the part of the trustees must be sufficiently serious as to amount to a breach of fiduciary duty. Breach of duty is essential (in the full sense of that word) because it is only a breach of duty on the part of the trustees that entitles the court to intervene (apart from the special case of powers of maintenance of minor beneficiaries, where the court was in the past more interventionist: see para 64 above). It is not enough to show that the trustees' deliberations have fallen short of the highest possible standards, or that the court would, on a surrender of discretion by the trustees, have acted in a different way. Apart from exceptional circumstances (such as an impasse reached by honest and reasonable trustees) only breach of fiduciary duty justifies judicial intervention.'[38]

One might wonder in what circumstance an action to which trustees give inadequate consideration falling within the formulation of the Principle in *Mettoy* or *Sieff* resulting in a sufficient loss to a trust fund to justify an application to the Court would not involve a breach of trust by the trustees. Lord Walker considered two possibilities. First, he considered the situation where the trustees rely on expert advice. That was the case both in *Futter* and in *Pitt* and that issue is considered below. Secondly, as is common where there are professional trustees, where the trust includes an exoneration clause under which the trustees are excused from liability for a breach arising in good faith.

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33 *Futter & Pitt CA* para 222
34 *Futter & Pitt SC* para 91
35 *Abacus Trust Company (Isle of Man) Ltd v Barr* [2003] Ch 409
36 *Abacus Trust Company (Isle of Man) Ltd v Barr* [2003] Ch 409 at para 23
37 *Sieff v Fox* [2005] EWHC 1312 at para 80
38 *Futter & Pitt SC* para 73

Lord Walker records the argument of Counsel for HMRC who pointed out that:-

> 'Even if a trustee is exonerated from liability to pay equitable compensation, he is still liable to injunctive relief to prevent a threatened breach of trust, and personal and proprietary remedies may be available against persons who receive assets distributed in breach of trust. Moreover an exoneration clause does not protect a trustee against removal from office by order of the court.'[39]

So the argument was that an exoneration clause does not stop a trustee being in breach – it merely relieves him of liability for that breach.

Lord Walker did not expressly accept that argument or conclude that there can never be a situation in which an exoneration clause might have the effect that the trustee is not in breach of his duty as a trustee with the result that the Principle could not apply. He did go on to say, however, that:-

> 'The Futter No 3 and No 5 settlements contain exoneration clauses in conventional terms, stating that "in the professed execution of the trusts and powers hereof no trustee shall be liable for a breach of trust arising from a mistake or omission made by him in good faith". I would not treat that clause as ousting the application of the *Hastings-Bass* rule, if it were otherwise applicable.'[40]

Void or Voidable

The formulation of the Principle in *Mettoy* and *Sieff* is that where the conditions of the Principle are satisfied 'the Court will interfere with [the trustees] action'. That does not specify the action which the Court will take but it does not seem to allow the Court to take no action at all. If the Court finds that an act is void, it finds that it has, in law, never taken place. If an act is voidable, it will be fully effective unless a beneficiary applies to the Court for the act to be avoided. In that case the remedy is discretionary. The Court need not grant it if it considers that it will be inequitable to do so and, in particular, where any of the equitable bars, laches, complicity or acquiescence, are present. The Court may not be able to interfere with all of the consequences of the impugned action if, for example, there are third party purchasers for value without notice of the breach. In *Abacus Trust Company (Isle of Man) Ltd v Barr*, Mr Justice Lightman concluded that transactions falling within the Principle were voidable and in *Sieff* Lord Justice Lloyd said that he was attracted to the view that the acts were voidable rather than void but that he considered that the matter required further consideration in the light of earlier authority.[41]

The Effect of a Voidable Transaction being Avoided

Writing in *Taxation* on *Futter ChD* on 3rd June 2010, Keith Gordon and Joseph Howard commented:-

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[39] *Futter & Pitt SC* paras 19 and 89

[40] *Futter & Pitt SC* para 89

[41] *Sieff and others v Fox and others* [2005] EWHC 1312 (Ch) at paras 79 to 82

> 'The consequences for tax purposes of an appointment being void *ab initio* would be that the beneficial ownership never passed to the appointee (here Mr Futter and his children). Although the trustee conveyed possession of, and the legal interest in, the money, the appointees held it on constructive trust for the beneficiaries under the original trusts. Consequently, they would not have triggered capital gains tax charges in respect of the stockpiled gains on receipt of the capital payments.
>
> HMRC had argued that, even if the rule applied, it made the appointments voidable so that, although the trustee could claw back the money appointed, subject to certain defences, until then, they had still actually transferred the beneficial interest in the money, so that the capital payments were effective for tax purposes. Hence, the rule would give taxpayers no defence against tax charges which had arisen before any declaration of voidness by the court.'

When the Court exercises its discretion to avoid a transaction, however, it seeks to put the parties into the position they would have been in had the voided transaction not taken place subject to preserving the rights of bona fide third party purchasers for value. The tax authorities are not in the position of a bona fide third party purchaser for value without notice. Taxation is a statutory consequence of a transaction taking place.

In the Court of Appeal in *Futter & Pitt* Lord Justice Lloyd said:-

> 'As a general proposition (which is probably an over-simplification), tax is due on or as a result of transactions which are effective, not those which are not. In the case of IHT, a specific provision in s 150 of the Inheritance Tax Act 1984 means that it does not matter whether a transaction is void or is set aside as voidable. In either case any tax paid on the transaction is to be repaid and any calculation made by reference to the transaction is to be redone without reference to it. [Counsel for HMRC] told us that, without making any concession, he understood the position to be likewise in respect of other taxes. That may not be so in every case, but in principle it seems to be right, even though principle may not always be the decisive factor in relation to fiscal legislation.'[42]

It would seem then that for fiscal purposes the effect of a transaction being avoided under the Principle will be that it is treated as if it had not occurred although that simple rule may be subject to variation, in a manner which will, no doubt, be explored in later cases, where it is not possible for the Court to achieve a *restitutio in integrum.*

Would or Might

It can be seen that in the formulations of the Principle in *Mettoy* and *Sieff*, it is a requirement that were it not for the inadequate consideration the trustee 'would not have acted as he did'. In *Stannard v Fisons Pensions Trust Limited*[43] in which *Hastings-Bass* but not *Mettoy* was cited, Lord Justice Buckley's formulation was modified, without any full discussion of the point, so that the test was expressed to be

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42 *Futter & Pitt CA* para 91

43 *Stannard v Fisons Pensions Trust Limited* [1991] PLR 225

what the trustees might, rather than would, have done if fully informed. On this issue, the Supreme Court in *Futter & Pitt SC* declined to lay down a clear rule.

> '…as a matter of principle there must be a high degree of flexibility in the range of the court's possible responses. It is common ground that relief can be granted on terms. In some cases the court may wish to know what further disposition the trustees would be minded to make, if relief is granted, and to require an undertaking to that effect (see *In re Baden's Deed Trusts* [1971] …). To lay down a rigid rule of either "would not" or "might not" would inhibit the court in seeking the best practical solution in the application of the *Hastings-Bass* rule in a variety of different factual situations.'[44]

To Whom Does The Rule Apply?

As we shall see, Mrs Pitt was a receiver and not a trustee. In the High Court Counsel for HMRC had argued that the Principle was restricted to trustees and did not extend to other persons, such as Mental Health Act receivers, who were fiduciaries. The High Court declined to restrict the Principle in this way finding that:-

> ' … there is no material distinction between a trustee exercising a power for the benefit of a beneficiary under a trust instrument and a receiver exercising a power for the benefit of a patient pursuant to the Mental Health Act 1983.'[45]

The High Court found, therefore, that the Principle could apply to a Mental Health Act receiver although it did not express an opinion as to whether all fiduciaries would be within the Principle:-

> 'I do not consider that applying the rule to a receiver under the Mental Health Act 1983 necessarily entails extending it to all fiduciaries. The nature of different fiduciary relationships is very variable. Often a fiduciary will be required to follow the instructions of a principal. In such a case, it may be that the *Hastings-Bass* principle would not apply, although I should not be taken as expressing any view on the question. I am solely concerned with a discretionary power exercised by a receiver for a patient under the Mental Health Act 1983.'[46]

HMRC did not advance this argument in its appeal to the Court of Appeal and in the Supreme Court.

Is Tax A Special Case?

In *Futter ChD* the Counsel for HMRC suggested that the impugned action of the trustees 'was not in any meaningful sense different from that which they intended' because it only differed as to tax consequences. Mr Justice Norris commented that 'this argument has echoes of the distinction between "effects" and "consequences"

[44] *Futter & Pitt SC* para 92
[45] *Pitt ChD* para 39
[46] *Pitt ChD* para 38

which, in the context of equitable relief from mistake, Millett LJ drew in *Gibbon v Mitchell* …'.[47]

Lord Walker in the Supreme Court referred with approval[48] to Lord Justice Lloyd's consideration in the Court of Appeal of the duties of trustees in exercising their discretion, and in particular the relevance of tax considerations. So it is clear that tax is a consideration which, in appropriate circumstances, trustees may have a duty to take into account. As we shall see, however, whether or not impugned transactions form part of a tax avoidance scheme may also be relevant as to the question of whether or not the Court will exercise its discretion to grant a remedy.

How Will the Court Exercise its Discretion in Tax Avoidance Cases?

Because the Supreme Court has held that transactions within the Principle are voidable and not void, where the conditions of the application of the Principle are satisfied, the Court will have a discretion as to whether or not to grant a remedy.

In *Pitt*, the Supreme Court held that they could set aside Mr Pitt's transaction on the basis not of the Principle but of Mistake. In *Futter* the appellants did not raise the issue of Mistake until the hearing in the Supreme Court and the Court declined to permit the appellants to raise it for the first time 'primarily because there was no sufficient evidential basis for considering that issue …'.[49] Lord Walker went on, however, to consider how the Court might exercise its discretion in transactions which were intended to be tax avoidance transactions. Lord Walker said:-

> 'Had mistake been raised in *Futter* there would have been an issue of some importance as to whether the Court should assist in extricating claimants from a tax-avoidance scheme which had gone wrong. The scheme adopted by Mr Futter was by no means at the extreme of artificiality (compare for instance, that in *Abacus Trust Co (Isle of Man) v NSPCC*) but it was hardly an exercise in good citizenship. In some cases of artificial tax avoidance the court might think it right to refuse relief, either on the ground that such claimants, acting on supposedly expert advice, must be taken to have accepted the risk that the scheme would prove ineffective, or on the ground that discretionary relief should be refused on grounds of public policy. Since the seminal decision of the House of Lords in *WT Ramsay Ltd v IRC* there has been an increasingly strong and general recognition that artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures. But it is unnecessary to consider that further on these appeals.'[50]

The view that tax avoidance is 'a social evil' is startling and seems to have less to do with the movement of opinion in the thirty-two years since *Ramsay* was heard than with the volatile state of public opinion since the financial crash of 2008. It contrasts oddly with the decision in *Hastings-Bass*, where the Court found for the trustees in refusing to regard their entire transactions as a nullity in circumstances where to do

[47] *Futter ChD* para 20
[48] *Futter & Pitt SC* paras 58 and 63
[49] *Futter & Pitt SC* para 135
[50] *Futter & Pitt SC* para 135

so would have resulted in a large liability to estate duty. In that case, the impugned transactions were part of:-

> 'a scheme which was described by Captain Hastings-Bass in a contemporary letter as "a scheme whereby some of the enormous death duties may be reduced on the settlement"'.[51]

As the Supreme Court has held that, where the Principle applies, the impugned transactions are voidable not void similar issues will arise in the Court's determination of the appropriate remedy as arise in Mistake. Applications seeking to avoid transactions undertaken for tax avoidance purposes which have turned out to have deleterious taxation results are no longer likely to benefit from the Court's exercise of its discretion.

THE DECISION ON THE FACTS

Pitt

The facts[52] of *Pitt* are tragic.

Mr and Mrs Pitt were persons of relatively modest financial resources who lived together in a farmhouse near Frome. On the day of his 57th birthday, on 6 April 1990, Mr Pitt was badly injured in a road accident, suffering multiple injuries including very serious head injuries such that he became permanently unable to manage his own affairs. By the end of November 1992 Mrs Pitt had been appointed as his receiver under the Mental Health Act 1983. In 1994 their house, held as joint tenants, was worth £400,000 but was subject to a charge in favour of Lloyd's Bank securing a loan of £210,000. Mr Pitt had two pensions, neither of which were in payment, one being very small and the other affording a lump sum of £12,500 and a pension of £3,700 pa. They had £15,000 in the bank. Mr Pitt's care needs were calculated at £55,000 per year.

With his wife acting as his next friend, Mr Pitt issued proceedings for damages against the other driver who had been involved in the road accident in 1991 and this damages claim was settled by an agreement for a structured settlement which was approved by the Court on 9th May 1994. At that point an interim payment of £350,000 had already been made. The settlement figure was £1.2 million (less the interim payment) and the balance of £850,000 was to be satisfied by an outright payment of £420,000 and monthly payments amounting to £29,025 pa but index linked to the RPI.

Mrs Pitt was advised by the solicitors who acted for her in the litigation against the driver and by a firm of financial advisers.

The financial advisers advised Mrs Pitt to settle both the lump sum and the right to the monthly payments on discretionary trusts primarily because this would avoid having to pay fees to the Court of Protection in respect of dealings with an invested

51 *Re Hastings-Bass (deceased); Hastings and others v Inland Revenue Commissioners* [1974] STC 211 at page 215

52 The succeeding summary draws on *Pitt ChD* paras 5-15 and *Futter & Pitt CA* paras 146-158

fund which she would have had to do if Mr Pitt held the moneys personally. It was also said to have some other minor advantages that did not materialise. The financial advisers provided Mrs Pitt with a report on the Income Tax and Capital Gains Tax advantages of the proposed settlement. Neither the solicitors nor the financial advisers addressed the issue of potential Inheritance Tax. It was the financial advisers who provided two precedents for the proposed trust, one of which would have satisfied the conditions of IHTA 1984 s.89 (trusts for disabled persons) but for some reason, which is not apparent from the case reports, it was the other precedent that was used.

The Court of Protection authorised (but did not direct) Mrs Pitt to make the settlement. On 1st November 1994, she did so settling both the lump sum and the right to the annuities at a combined value of about £800,000. Although it was not realised at the time, that was an immediately chargeable transfer triggering an Inheritance Tax liability of about £100,000. Had the trust used been either an interest in possession trust or a trust complying with s. 89, no chargeable transfer would have arisen. At the time of the High Court hearing the uncontroverted evidence was that the potential liability including both interest and penalties would be between £200,000 and £300,000.

The settlement was a relevant property settlement subject to ten yearly and exit charges which also would not have applied if the settlement has been within s.89 or had conferred an interest in possession. At the time of the Court of Appeal hearing the liabilities arising from these charges had not been calculated.

Under IHTA 1984 s.199 Mr Pitt, and therefore his estate, and the trustees would be liable for the tax on the chargeable transfer. The trustees would be liable for the tax arising under the 10-year charge under IHTA 1984 s.201. Both the trustees and Mr Pitt would be liable for the tax arising from exit charges on advances of capital under IHTA 1984 s.201. In respect of all three charges, the charge on Mr Pitt and the ten-yearly and exit charges on the trustees, IHTA 1984 s.237 would have imposed an Inland Revenue charge on the trust property and on any property resulting from advances to Mr Pitt with effect from the date of the relevant disposition. Mrs Pitt was a trustee and the sole beneficiary of her husband's estate on his death.

The distributions of the trust property which were made by the trustees during Mr Pitt's life could still have been made had the settlement been an interest in possession trust or a trust satisfying IHTA 1984 s.89. So it appears that there was no advantage whatsoever in the trust being a general discretionary trust rather than a trust complying with IHTA 1984 s.89.

The money in the settlement was used, amongst other things, to adapt Mr and Mrs Pitt's house and to pay for 24 hour care for Mr Pitt. A carer lived in, and she and Mrs Pitt cared for Mr Pitt between them, each having two weeks on and two weeks off.

Towards the end of 2003, when advice was being sought about Mr and Mrs Pitt's wills, Mrs Pitt became aware of the Inheritance Tax liability. Proceedings for professional negligence were issued against the financial advisers (but not, it appears against the solicitors) by Mr Pitt, acting by Mrs Pitt, and the Trustees of the Settlement. The financial advisers denied liability on the ground that, inter alia, they were not retained to advise on the Inheritance Tax consequences of the Settlement. The action was stayed pending the outcome of the application based on the Principle.

Mr Pitt died on 25th September 2007. At the time of his death only £6,259 remained within the Settlement. The right to the monthly payments lapsed with his death. The index-linked monthly payment had risen to about £40,000 per annum before Mr Pitt's death and, no doubt, the costs of his care would have increased by more than inflation.

THE FACTS IN FUTTER

Futter

The facts[53] in *Futter* can be stated much more briefly. Mr Futter made two non-resident settlements in 1985. Those settlements realised 'stockpiled' gains within TCGA 1992 s.87. Due to changes in the law relating to non-resident settlements made in 1998, the settlements conferred no continuing Capital Gains Tax advantage. The stockpiled gains, however, would only be brought into charge if capital payments were made to UK resident beneficiaries. In 2004 the non-resident trustees resigned and Mr Futter and a professional, who were both UK residents, were appointed in their place. The trust therefore became UK resident.

The professional trustee was a partner of a major firm of solicitors with a high reputation in private client matters (the 'Solicitors'). Mr Futter wanted the trustees to advance the trust assets out of the trust in a way that did not give rise to Capital Gains Tax liabilities. At first the plan was merely to advance assets of a sufficient amount to use up the annual exemptions of Mr Futter and his three children and so, over a period of years, to use up the stockpiled gains without triggering a tax charge. Mr Futter, and the children, however, had other assets with unrealised losses on them. Mr Futter conceived a plan to realise these losses and for advances to be made out of the trust triggering gains under s.87 against which the losses would be offset thus allowing the trust assets to be advanced more quickly. On 28th March 2008 his accountant telephoned the Solicitors and an assistant solicitor confirmed that the losses on Mark Futter's personal portfolio could be offset against the stockpiled gains in the trust that would be attributed to him on the distribution of the trust fund.

Distributions were made both to Mr Futter and to his children. Unfortunately, the Solicitors had overlooked the fact that personal losses could not be offset against s.87 gains because of TCGA 1992 s.2(4). The result was that Mr Futter realised a large Capital Gains Tax liability and his three children were also charged to tax of £1,792 each on distributions of £12,000 each.

In September 2008 the Solicitors realised that they had made a mistake and the Trustees subsequently applied to the Court for a declaration that the advances were void under the Principle.

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53 The succeeding summary is based on *Futter ChD* paras 8-17, *Futter & Pitt CA* paras 133-135 and *Futter & Pitt SC* paras 47-49

THE DECISIONS ON THE FACTS

Pitt

In *Pitt* it was held that the Principle did not apply because there was no breach by Mrs Pitt because she had taken advice from appropriately qualified advisers.

> 'As her husband's receiver under the Mental Health Act 1983, Mrs Pitt was in a fiduciary position but there is no suggestion that she had any professional qualifications. She devoted herself, alternating with a carer, to looking after her disabled husband. As anyone in that position would, she took professional advice from solicitors and specialist consultants. After hearing from her legal advisers and the Official Solicitor the Court of Protection made an order on 1st September 1994 authorising (not directing) her to execute the SNT and she acted on that authority on 1st November 1994 … She had taken supposedly expert advice and followed it. There is no reason to hold that she personally failed in the exercise of her fiduciary duty.'[54]

In the Court of Appeal, Lord Justice Lloyd seems simply to have assumed that one of her advisers must have been under a duty to provide advice on Inheritance Tax:-

> 'It is clear that Mrs Pitt did not have in mind, and therefore did not take into account, the prospect of a charge to IHT, but it is equally clear that she did seek proper professional advice, and she acted on it. Frenkel Topping deny that they were under a duty to advise her about IHT. However that may be, it seems to me that, as between the various advisers which acted for and advised her, it must have been the duty of one or other of them, at least, either to advise her about any risk as to IHT, or to point out that she might need such advice and see that she got it. While some trustees are well aware of the fiscal risks that their actions may give rise to (as Mr Mark Futter was), that will not be true of all trustees or persons in a fiduciary position. It must be a sufficient discharge of the duty of skill and care of such a person to retain appropriate professional advisers, whose duty it is to either to give the necessary advice or to point out areas on which advice may be needed which should be sought from another adviser.'[55]

Mrs Pitt was not a trustee but the standard of care which applied to trustees at the time she made the settlement must be at least indicative of the standard which would apply in deciding whether she was in breach of her fiduciary duty. The common law standard, at least in respect of trustee investment, was:-

> '… to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.'[56]

It does not appear that Mrs Pitt had taken an action for negligence against her solicitors and the financial advisers resisted her action on the grounds that they were not engaged to provide Inheritance Tax advice. The judgments do not reveal

[54] *Futter & Pitt SC* para 97
[55] *Futter & Pitt CA* para 162
[56] *Re Whiteley* (1886) 33 ChD 347 at p.355

whether that defence is well founded. It would be surprising, however, if a person in a fiduciary position who engaged advice from solicitors and financial advisers on such terms that neither were liable in respect of the advice they gave although catastrophic loss resulted from acting on that advice had exercised a sufficient degree of care. Rather one would expect the fiduciary to be in breach of his duty because he had engaged advice on a limited basis which did not cover all of the issues that might be relevant to the transactions.

It will remain to be argued in future cases on the Principle that a trustee or other fiduciary who has relied on advice in circumstances where that advice did not cover the relevant issue and where the terms on which he had engaged that advice precluded him from recovering damages for negligence from the adviser, had been reckless and had therefore been in breach of his fiduciary duty.

Futter

In *Futter* the Supreme Court also concluded that the trustees were not in breach because they took appropriate advice. The complication was that, as we have seen one of the trustees was a partner in the firm that gave the advice. Lord Walker dealt with this difficulty in the following way:-

> 'The only complication was that Mr Cutbill (the solicitor-trustee) was a member of both teams: the solicitors giving the erroneous advice, and the trustees receiving and acting on it. I agree with the Court of Appeal that it would be artificial to distinguish between the two trustees, who acted together in making and effectuating their decisions. I would if necessary go further and hold that the documentary evidence indicates that most if not all of the technical tax advice given by his firm came not from Mr Cutbill but from the assistant solicitor who was working with him, from January 2008, in a review of a number of different Futter family settlements. Until 27th March 2008 it was supposed, wrongly, that the No 3 settlement's stockpiled gains were relatively small, and the fact that they amounted to about £188,000 led to a last-minute change of plan. On 28th March 2008 there was a telephone conversation between the assistant solicitor and Mr Bunce, Mr Futter's accountant, at which, without reference to Mr Cutbill, she definitely confirmed that Mr Futter's personal losses could be set off against the s.87 gains. Mr Cutbill seems to have been, very properly, reluctant to put the blame on a junior member of his firm, and of course his firm must take legal responsibility for any actionable mistake by any of its fee-earners. But the documents in exhibit "CDC 1" to Mr Cutbill's witness statement tend to confirm that he should not, as a trustee of the No 3 and No 5 settlements, be treated as having been personally in breach of fiduciary duty.'[57]

It is not at all clear why Lord Walker thinks that it would have been artificial to distinguish between the two trustees. One was a highly experienced solicitor working for a law firm noted for their expertise in private client matters including taxation and the other was an individual who the reports do not suggest had any legal qualification. The reader of the judgment doesn't have the advantage of reading the documents to which Lord Walker refers but it seems strange, at least, to suggest that

[57] *Futter & Pitt SC* para 96

a partner, who is jointly and severally liable for the acts of his partnership, is not a person who provides the advice of that partnership to the trustees and, therefore, is not a person who is responsible for its accuracy when he acts upon it as trustee and, therefore, is not in breach when the trust suffers loss as a result. It cannot have been the assistant solicitor who provided the advice because she had no contractual relationship with the trustees but, rather, was acting on behalf of the partners of whom the trustee was one.

At the very least, the Court's conclusion that there was no breach in *Futter*, which was based upon an evaluation of the particular facts in the case, cannot be seen as determining the conclusion which would be drawn on similar but different facts.

PROCEDURAL MATTERS

Proceedings by Trustees

In the Supreme Court Lord Walker said:-

> 'It is a striking feature of the development of the *Hastings-Bass* rule that it has led to trustees asserting and relying on their own failings, or those of their advisers, in seeking the assistance of the court. This was pointed out in no uncertain terms by Norris J in his first-instance judgment in *Futter*... There may be cases in which there is for practical purposes no other suitable person to bring the matter before the court, but I agree with Lloyd LJ's observation (para 130) that in general it would be inappropriate for trustees to take the initiative in commencing proceedings of this nature. They should not regard them as uncontroversial proceedings in which they can confidently expect to recover their costs out of the trust fund.'[58]

It is not all clear why it would be inappropriate for trustees to institute proceedings in these circumstances. Their duty is to protect the trust fund. If the trust fund is in danger of suffering loss because of their breach, their duty is surely to try to correct the matter. The question of whether they can recover the costs of doing so against the trust fund is surely entirely separate from the question of whether it is appropriate for them to institute the proceedings which are designed to benefit the trust fund and, only incidentally if at all, themselves.

Joinder

In *Futter & Pitt* HMRC were joined as a party in the action. It was HMRC who appealed against the High Court's decision. On what basis were they joined?

Katharina Byrne wrote a fascinating article[59] in *Private Client Business* on HMRC's standing to intervene in trust proceedings in which she concluded that:-

> '… there is a strong case for denying HMRC's standing in certain trust proceedings. The primary reason is that HMRC simply do not have a sufficient interest in the proceedings, only in their outcome. Furthermore, even if it were

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58 *Futter & Pitt SC* at para 69

59 '*HMRC's Standing to Intervene in Trust Proceedings*', *Private Client Business*, Issue 5 2011

accepted that HMRC's interest was sufficient, it is not necessary that they be joined. Provided that all parties to the application ensure that full argument is put before the Court, HMRC need not be called upon or indeed permitted, to fulfil this role.'

That was a conclusion on the general question of joinder in trust proceedings as it applies to HMRC. Nonetheless, her analysis was developed taking full account of the decision in *Futter & Pitt CA* and there is nothing in the Supreme Court's decision to modify it. It seems to apply squarely to HMRC's position in respect of the matters at issue in *Futter & Pitt*. Their interest in the proceedings was not in the matter at issue which was whether the impugned transactions should be set aside or not. Their interest was in the financial results of that issue because, if the transactions were void or avoided, no tax charge could arise by reference to them.

The situation in *Futter & Pitt* was very different from that in *Re Hastings-Bass* itself where HMRC were a party. Their being a party in that case was readily explicable because the question put in the originating summons by the trustees was whether Estate Duty became payable. Accordingly, in *Re Hastings-Bass* HMRC had an 'interest in the proceedings [and not] only in their outcome' in contrast to their interest in *Futter & Pitt*.

THE BEHAVIOUR OF HMRC

Finally in relation to this case one must question the moral propriety of HMRC's conduct. The final result of the litigation was that Mrs Pitt was successful in that her husband's transaction was avoided and no Inheritance Tax liability arose. In order to reach that point Mrs Pitt had to suffer years of uncertainty facing the prospect of a liability which, on the face of the facts revealed in the case, could have ruined her and deprived her of her home.

She first discovered the potential Inheritance Tax liability in 2003. Her disabled husband died in 2007. The High Court hearing took place on 21st October 2009. It is normal for cases to take several years before they come to Court so it is reasonable to assume that Mrs Pitt was faced with the prospect of these proceedings before the death of her husband in 2007. For seventeen years she cared for a mentally disabled husband who had suffered a terrible misfortune. For the last four years of his life and for six years thereafter it would appear that Mrs Pitt would have had to bear the very considerable additional strain of facing financial ruin.

Apart from the issue as to whether or not the Principle could apply to fiduciaries other than trustees, an argument HMRC quickly abandoned when it was roundly dismissed in the High Court, Mrs Pitt's circumstances fell squarely within the Principle as it was universally understood until the Court of Appeal gave its judgment in her case in 2011. The proceedings were only kept alive by the decision of HMRC to appeal against the High Court's decision. Both before the High Court's decision and after it, HMRC could quite properly have concluded that the facts of the case did not justify their incurring the risks of litigation. They did not need to litigate *Pitt* in order to obtain a review of the Principle by the Court of Appeal because they held the option of opposing the application in *Futter* ChD and of appealing against the decision in that case on its own. HMRC's decision to appeal against the High Court's decision in *Pitt*

ChD gave them no advantage, wasted public money and subjected a woman who had suffered the most appalling misfortune to years of stress and strain during a period in which she was at first caring for her seriously disabled husband and then mourning his loss.

It is surely very disturbing that there were, one presumes, individuals in HMRC who thought that was a reasonable course of action to take and that nobody in the Department saw fit to interfere with their decision.