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trusts & probate

The demise of the rule in *Re Hastings-Bass*

Summary

On 9 March 2011 Lord Justice Lloyd delivered the judgment of the Court of Appeal in the combined appeals of *Pitt v Holt* and *Futter v Futter*[1], reviewing the circumstances in which acts of a trustee in exercise of discretionary dispositive powers may be set aside if they have unexpected, undesirable consequences. In particular, Lloyd LJ reviewed the "rule" found in *Re Hastings-Bass*[2], *as* developed in a series of subsequent cases, and determined that the rule was not in fact good law.

The following key points emerge from the judgment:

- the exercise by a trustee of a discretionary power is void if it is: (i) outside the terms (either procedural or substantive) of the power, or (ii) for an extraneous purpose;
- where the exercise is within the terms of the power it will be voidable if tainted by breach of fiduciary duty by the trustee;
- if a trustee of a private discretionary trust fails to take into account fiscal considerations in exercising a discretionary power he may not be able to show a genuine attempt to exercise the discretion in good faith with a fair consideration of the subject and therefore may be in breach of fiduciary duty;
- if the trustee has obtained and considered reputable professional advice as to fiscal consequences, the trustee will not be in breach of fiduciary duty in respect of the exercise of the discretion where the advice turns out to be mistaken;
- a gift will be set aside on the grounds of mistake where (i) there is a mistake by the donor as to the legal effect of the disposition or as to a fundamental fact and (ii) the mistake is of so serious a character as to render it unjust on the part of the donee to retain the property given to him; and
- unforeseen fiscal consequences of a gift are not a legal effect and so do not *per se* bring the jurisdiction to set aside into play.

A further appeal to the Supreme Court is anticipated.

What was the rule in *Re Hastings-Bass*?

Lloyd J (as he then was) had also decided *Sieff v Fox*[3], one of the cases subsequent to *Re Hastings-Bass.* In *Sieff* he set out what he considered to be "the rule in *Re Hastings-Bass"* as it had by then developed:

"*Where trustees act under a discretion given to them by the terms of the trust, in circumstances in which they are free to decide whether or not to exercise that discretion, but the effect of the exercise is different from that which they intended, the court will interfere with their action if it is clear that they would not have acted as they did had they not failed to take into account considerations which they ought to have taken into account, or taken into account considerations which they ought not to have taken into account."*

[1][2011] EWCA Civ 197; [2][1975] Ch. 75; [3][2005] EWHC 1312 (Ch)

Fladgate LLP 16 Great Queen Street | London WC2B 5DG
T +44 (0)20 3036 7000 | F +44 (0)20 3036 7600 | www.fladgate.com

The rule has typically been invoked in circumstances where an act of a trustee has unforeseen negative tax consequences – sometimes only becoming apparent years after the event.

Why was the rule controversial?

A void transaction is of no legal (or fiscal) effect: it may not be enforced by a party to it; property (including tax) paid out in reliance on it may be recovered by a claim for restitution. The exercise of a discretionary power will be void if it is outside the limits of the power, either as a matter of procedure or substance. It will be void if it is exercised otherwise than for the purpose for which it was conferred: then it is termed a "fraud on the power".

The rule, as expressed in *Sieff,* provides that a trustee's exercise of a discretionary power may be vitiated by the trustee taking into account irrelevant considerations or failing to take into account relevant considerations. This does not correspond to either of the established instances of void exercises of a power stated above. It is not the *ultra vires* exercise of a power. It is not the exercise of a power for an extraneous purpose.

Voidable transactions have full legal (and fiscal) effect but may in some circumstances be rescinded (set aside) by the court on the application of a wronged party. Voluntary dispositions may be set aside at the instance of the donor if procured by a breach of fiduciary duty by the donee. Examples include: (i) the wife who guarantees her husband's business debts by grant of security over the marital home without full knowledge of the implications of the transaction, and (ii) testatory legacies to unscrupulous relatives. The gift will only be set aside if it can be shown that the relationship between donor and donee is fiduciary and that the gift was procured by a breach of the fiduciary duty of loyalty.

Not all duties owed by trustees to their beneficiaries are fiduciary:

"It is similarly inappropriate to apply the expression [fiduciary duty] to the obligation of a trustee or other fiduciary to use proper skill and care in the discharge of his duties. If it is confined to cases where the fiduciary nature of the duty has special legal consequences, then the fact that the source of the duty is to be found in equity rather than the common law does not make it a fiduciary duty"[4]

and

"*the liability of the fiduciary for the negligent transaction of his duties is not a separate head of liability but a paradigm of the general duty to act with care imposed by law on those who take it upon themselves to act for or advise others."*[5]

So what duties are owed by the trustee to his beneficiaries in exercising discretionary powers and are those duties fiduciary?

A trustee's discretion must be exercised: "with an entire absence of indirect motive, with honesty of intention, and with a fair consideration of the subject"[6], it must not be "merely wanton or capricious"[7]. These duties are undoubtedly fiduciary in nature – going to whether or not the trustee has made an honest attempt to exercise the discretion in the best interests of the beneficiaries. However, it is not a breach of fiduciary duty to make a mess of things: a trustee may still be honest "no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been"[8]. On this basis, a misunderstanding of UK tax legislation may be a breach of duty of skill and care, but it is not a breach of fiduciary duty. Accordingly, where, in the context of the rule in *Re Hastings-Bass*, the failure to take into account relevant considerations and exclude irrelevant considerations related to a misunderstanding of tax legislation, it appears that dispositions were being set aside as a result of negligence, rather than breach of fiduciary duty.

The fact that a commercial transaction has been effected negligently does not of itself entitle the party who suffers loss as a result to rescind the

[4] *Bristol & West Building Society v Mothew* [1998] Ch. 1 at pp. 16-18; [5] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, at p.205; [6] *Re Beloved Wilkes' Charity* (1851) 3 Mac & G 440; [7] *Re Pilkington's Will Trusts* [1964] AC 612; [8] *Armitage v Nurse* [1998] Ch. 241

transaction. There would otherwise be unacceptable impact on non-volunteer third party rights and loss of commercial certainty. The rule, as expressed in *Sieff*, in permitting rescission of a transaction for what may in truth be negligence rather than breach of fiduciary duty appeared to offer "a magical morning after pill"[9] to negligent trustees but not to anyone else.

Lloyd LJ's analysis of *Re Hastings-Bass*

Six years after he decided *Sieff*, and with the benefit of full argument after the Revenue had intervened for the first time since *Re Hastings-Bass*, Lloyd LJ determined that the decision in *Re Hastings Bass* did not bear out the rule that took its name: he was required to "put the law back on the right course" after it had taken "a seriously wrong turn". That wrong turn had been the misidentification of the true *ratio decidendi* of the case.

The English statutory power of advancement, section 32 Trustee Act 1925, provides (in part) that "trustees may at any time or times pay or apply any capital money subject to a trust, for the advancement or benefit, in such manner as they may, in their absolute discretion, think fit, of any person entitled to the capital of the trust property or of any share thereof…" (empahsis added). It was this discretionary power that the trustees in *Re Hastings-Bass* had sought to exercise. They had made an advancement by way of sub-settlement intended to confer a life interest for the settlor's 10 year old son, William Hastings-Bass, and thereafter trusts in favour of William's future issue. In fact, the trusts of the sub-settlement intended to take effect after the life interest of William were void for perpetuity. The advancement had conferred a benefit on William by his life interest, but the further intended indirect benefits to him (by benefiting his future children) had failed. The Revenue argued unsuccessfully that the advancement as whole should fail - if it did the property then retained in the original settlement would have attracted duty at 73% on the death of the settlor. Thus a decision protecting a trustee's act from attack by the Revenue subsequently came to be relied on by trustees seeking to set aside their own dispositions.

Lloyd LJ identified the true *ratio* of *Re Hastings-Bass* as having two elements. First, trustees considering an advancement by way of sub-settlement must genuinely apply their minds to the question whether the sub-settlement as a whole will operate for the benefit of the person advanced. This does not extend to a principle that unless the trustees have considered all the consequences of the sub-settlement they cannot be said to have validly exercised their power at all. Secondly, if one or more of the provisions intended to be created cannot take effect it does not necessarily follow that those which can take effect should not be regarded as having been brought into being. If the provisions that can take effect can reasonably be regarded as being for the benefit of the advancee, then they should indeed take effect.

The two parts of this *ratio*, which specifically relates to section 32 powers of advancement, correspond to the established bases of void dispositions described above. First, genuine application of the mind requires the honest and reasonable exercise of the discretion but not the perfect understanding of all its consequences. Secondly, if the results of the exercise of the power of advancement when weighed together are not to the benefit of the advancee, then the advancement is outside the terms of section 32 and void for that reason.

Conclusions on Re Hastings-Bass

So, *Re Hastings-Bass* was not in fact authority for the rule that has borne its name for the past 35 years; Lloyd LJ's judgment was an attempt to limit the court's interference with a trustee's discretionary acts to established principles. A trustee's exercise of a discretionary power is only void if *ultra vires* or for an extraneous purpose. The exercise is voidable on the application of an affected beneficiary if made in breach of fiduciary duty.

[9]Per Lord Neuberger, in a speech to the Chancery Bar Association on 16 January 2009

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Interestingly, Lloyd LJ expressed the view that a failure to consider the impact of taxation on the exercise of discretionary dispositive powers by the trustee of a private discretionary trust could be a breach of fiduciary duty. His rationale appears to be that the creation of private discretionary trusts is so bound in with the desire to "deflect or defer" the impact of taxation that a failure to consider taxation on dispositions will cross the line from negligence into absence of good faith, honest consideration of the subject.

He acknowledged the surprising effect so produced. If a trustee does the right thing and seeks professional advice which turns out to be defective, the court will not interfere with the transaction. No claim lies against the trustee for breach of duty (either fiduciary or of skill and care), and so the trust fund can only be restored through professional negligence litigation with the adviser, with the time, effort and expense that entails. But where an imprudent trustee does not turn his mind at all to fiscal considerations, the beneficiaries may bring an action against him that may succeed in setting aside the transaction and reversing the tax charge. This apparent injustice was a price worth paying for Lloyd LJ to achieve consistency with authority.

Postscript on mistake

Lloyd LJ also clarified the circumstances in which the remorseful trustee might call in at the last chance saloon – a claim to set aside the disposition on the grounds of mistake. The trustee will have to own up to a mistake as to either the legal effect of the transaction or a fundamental fact in relation to it. The mistake will have to be of so serious a character as to make it unconscionable for the recipient of the disposition to retain the gift. An unexpected tax charge will generally not be sufficient to invoke the jurisdiction. ■

Stephen Hayes, Associate

Further information?

For assistance with any queries you may have, please contact:

Simon Ekins
Partner specialising in contentious trusts & probate, international arbitration and professional negligence

T +44 20 3036 7264
F +44 20 3036 7764
E sekins@fladgate.com

David Way
Partner specialising in tax and estate planning and structuring for individuals and businesses

T +44 20 3036 7370
F +44 20 3036 7870
E dway@fladgate.com

Stephen Hayes
Associate specialising in contentious trusts & probate, professional negligence and contractual disputes

T +44 20 3036 7113
F +44 20 3036 7613
E shayes@fladgate.com