RPC

Wealth and trusts quarterly digest

August 2018

Welcome to our latest Wealth & Trusts digest. Our quarterly digest is specifically tailored for you and aims to provide up to date commentary, analysis and guidance on key sector developments. It is written by our wealth and trusts teams to assist you and your clients in responding to market trends and legal developments. We would welcome the opportunity to discuss any issues you may have and always welcome feedback on the content of our publications.

Feature

Keeping up with changing circumstances: varying trusts and beneficial interests

Once a trust has been settled, circumstances may change so that its provisions are no longer fit for purpose. The terms of a trust may not be set in stone and can sometimes be varied, depending on the express terms of the trust, the position of the existing beneficiaries and the powers of the court. more›

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In our last update, we discussed the new investigative tool introduced by the Criminal Finances Act 2017, known as Unexplained Wealth Orders (UWOs). UWOs are designed to compel respondents to provide specific information to law enforcement agencies about questionable property. more›

Any comments or queries?

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Case reports

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Keeping up with changing circumstances: varying trusts and beneficial interests

Once a trust has been settled, circumstances may change so that its provisions are no longer fit for purpose. The terms of a trust may not be set in stone and can sometimes be varied, depending on the express terms of the trust, the position of the existing beneficiaries and the powers of the court.

Varying the terms of a trust: express powers and agreement

The trust documents may themselves give trustees the power to amend the terms of a trust. This could be a general power or a limited ability to amend particular provisions such as the governing law of the trust. Even if there are no express limitations on a power to amend, it can only be used in a manner which is compatible with the underlying purpose of the trust. As such, the power could not be used to amend a trust whose purpose was to benefit the successors of the settlor to a trust with solely charitable aims. However, depending on the wording of the relevant clause, it could permit the extension of the trustees' administrative powers, such as the power of investment, which may be helpful if existing powers are insufficient.

In the absence of an express power in the trust documents themselves, trustees could seek the consent of the trust's beneficiaries to depart from the terms of the trust. However, this option is only available to trustees if all of the potential beneficiaries are in existence, are over the age of 18 and have the capacity to agree to the proposed course of action.

Variation of Trusts Act 1958 (VTA)

If the trustees are unable to obtain the consent of all the beneficiaries because, for example, some are minors or do not have capacity, then the trustees may seek the court's approval of the variation under the VTA on behalf of such beneficiaries (although the application should be made by a beneficiary unless there are no beneficiaries who can consent to the variation).

The VTA gives the court broad powers to approve any arrangement varying or revoking the trust, or enlarging the powers of trustees regarding the management or administration of trust property. The VTA is often used where variations to the trust would secure some tax advantages for the beneficiaries, but it could also be used to secure minor amendments to the trustees' powers. When deciding whether to approve the variation, the court will consider whether the variation benefits (either financially or non-financially) the beneficiary on whose behalf the court is granting approval, and if it is the type of arrangement to which the court should give its blessing.

Intervention of the court in an emergency

The court has inherent jurisdiction to intervene in an emergency concerning trust property and to permit the trustees to take action which would not otherwise be authorised by the terms of the trust. The court has exercised this jurisdiction where trustees were obliged to sell property at a particular time which would be particularly disadvantageous. The court's power is limited to circumstances where the situation was not anticipated by the settlor or provided for in the trust instrument, the beneficiaries' consent cannot be obtained and the proposed course of action is in the beneficiaries' interests.

The court otherwise has no general power to vary trusts. As such, in the absence of express amendment powers or the consent of beneficiaries, trustees could try to rely on the court's power to vary a trust provided by statute, such as section 57 of the Trustee Act 1925 (TA).

Section 57 of the Trustee Act 1925

Where trustees wish to undertake a transaction in the management or administration of trust property but have no power to do so, a court may grant the trustees the necessary power under section 57 of the TA if it considers that the proposed transaction is expedient. The court can approve the amendment of the trust deed to include such a power, or simply authorise the transaction in question.

The courts have adopted a broad approach to what constitutes a "transaction" for these purposes and have, for example, authorised the extension of trustees' borrowing powers under the TA. The court will assess whether the transaction is in the best interests of the beneficiaries as a whole, and may take into account the wishes of the settlor if it is appropriate to do so. In contrast to an order under the VTA, a variation can be made under the TA even if some beneficiaries object.

The addition or removal of beneficiaries

The trust instrument may give the trustees express power to add or exclude beneficiaries, and there is authority to suggest that a general power to amend the trust as discussed above may permit a trustee to make such amendments. In exercising any such power, trustees should consider factors such as the interests of the present beneficiaries, the settlor's wishes, the purpose of the trust and the source of the trust assets.

A trustee may seek to add beneficiaries when to do so would be in the spirit of the settlor's wishes or the express purpose of the trust, for example, adding the younger siblings of named beneficiaries when it was the settlor's clear intention that all members of a particular branch of the family would benefit from the trust. It may also be in the interests of an existing beneficiary, particularly where there is a provision excluding the conferring of any benefit on a non-beneficiary. Such a situation could arise where it is favourable from a tax perspective for a beneficiary's spouse to be added as a beneficiary so that the spouse can receive distributions directly.

Alternatively, the trustees may be in a position where they wish to exclude a beneficiary. If the beneficiary is a member of a discretionary class, the trustee may decide that instead of excluding the beneficiary from benefit indefinitely, it would be preferable not to make any distributions to that beneficiary and wait to see if the circumstances change. However, there may be situations in which the permanent removal of a beneficiary is appropriate, and a beneficiary may choose to be excluded, for example, in order to secure a tax advantage, or as part of a financial settlement on a divorce.

Trustees are not able to exercise this power capriciously, so it is likely to be a breach of the trustees' duties to exclude a beneficiary on the basis that the beneficiary has made lifestyle choices of which the trustees disapprove, or because the beneficiary was raising legitimate enquiries about the running of the trust. If trustees are uncertain about whether an exclusion is appropriate, they could make an application to court seeking its approval of their decision.

If the trustees do not have the express power to add or remove beneficiaries they could seek the beneficiaries' consent to the proposed amendment. If some beneficiaries are unable to consent to a proposed variation then an application to court could be made under the VTA. The court does not otherwise have the power to approve the exclusion or addition of beneficiaries.

Summary

If the terms of the original trust instrument, or the class of beneficiaries, appear to be inappropriate in light of changed circumstances, trustees should check whether they are granted express powers to amend the trust. In the absence of an express power, the trustees may be able to obtain consent from the existing beneficiaries and court approval on behalf of particular classes of beneficiaries under the VTA. If the consent of the beneficiaries cannot be obtained, trustees may be able to seek the court's assistance under the TA.

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News

New inheritance tax disclosure regime

On 1 April 2018, new rules for the disclosure of tax avoidance schemes came into effect for inheritance tax. These rules aim to notify HMRC of tax avoidance schemes and how they work.

The rules provide that disclosure of the main elements of a tax avoidance scheme is required when such arrangements are created. This obligation arises where an informed user, having studied the arrangements and having regard to all the circumstances reasonably concludes that the two following conditions are met:

- the main benefit of the arrangements is to enable a person to obtain an inheritance tax advantage, and
- one or more "contrived or abnormal" steps are involved in the arrangement, without which, the tax advantage could not be obtained.

The advantages encompassed in the first condition above include:

- avoiding charges on assets that are placed in trust
- avoiding the implications of gifts falling under the reservation of benefit provisions, and
- transfers reducing the value of a person's estate which are not classed as a chargeable transfer or potentially exempt transfer.

With regard to the second condition, it must be unusual to carry out the steps without which the tax advantage would not be obtained. This is considered from the point of view of the "informed observer" who is suggested to be an independent person with the requisite knowledge and skillset to understand the scheme and relevant tax rules, albeit not an expert or tax practitioner.

HMRC's guidance provides some examples of arrangements that do not satisfy the second condition, such as straightforward trust arrangements.

Disclosure under the new rules applies to proposals made after 1 April 2018. For arrangements made before this date, the 'established practice' exemption ensures that a duty to notify does not arise if certain conditions are satisfied. The arrangement must implement a proposal entered into before 1 April 2018, which HMRC accepted as established practice and be substantially the same as the previous arrangement.

A copy of the new rules for the disclosure of tax avoidance schemes can be viewed here.

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Trusts Register: HMRC provides clarification on non-UK trusts holding UK residential property

In response to a query raised by the Society of Trust and Estate Practitioners (STEP), HMRC has clarified the tax position of trustees of offshore trusts that own UK residential property through non-UK companies.

In a letter sent in February 2018, STEP highlighted to HMRC that the purpose of the relevant inheritance tax legislation is to prevent the application of excluded property treatment to shares in non-UK companies. The legislation is not intended to regard the trustees of an offshore trust as owning UK residential property directly. It is therefore inappropriate to treat the trustees of offshore trusts as owning a UK asset, and it then follows that they should not be required to report under the trusts register.

HMRC has confirmed in its response to STEP that the government's position on this is that non-UK trusts are not reportable in the above circumstances as a result of the trust not owning any UK assets. Although HMRC published guidance on this subject late in 2017, the guidance, entitled "TRS – Frequently Asked Questions", remains listed as a draft only. Guidance on the trusts register is anticipated shortly and it is expected to reflect this revised position, although the exact date of publication remains unknown.

A copy of HMRC's response to STEP can be viewed here.

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UK authorities obtain first Unexplained Wealth Orders

In our last update, we discussed the new investigative tool introduced by the Criminal Finances Act 2017, known as Unexplained Wealth Orders (UWOs). UWOs are designed to compel respondents to provide specific information to law enforcement agencies about questionable property.

Although UWOs only came into force on 31 January 2018, UK authorities have already successfully exercised these new powers. The UK's National Crime Agency (NCA) has acted against an unnamed "politically exposed person" from central Asia to secure two UWOs in connection with assets worth a total of £22m.

The NCA believes that UWOs could significantly reduce the appeal of the UK as a destination for illicit income and will allow authorities to look to prime real estate in London, and elsewhere, to effectively target money laundering in the UK.

What is evident from the NCA's successful securing of UWOs is that the UK authorities are prepared to use UWOs in appropriate cases.

Although guidance as to best practice in responding to a UWO is yet to be published, it is to be hoped that the securing of the first two UWOs will lead to more information being published about the respondents' obligations in replying to a UWO, either by way of judicial decision or official guidance.

A copy of the NCA's press release can be viewed here.

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Case reports

South Downs Trustees Limited (as trustee of the South Downs Employee Benefit Trust) v GH, IJ and KL[1]

The High Court has approved the decision of a trustee of an employee benefit trust (the Trust) to overrule the provisions of the trust deed in response to unforeseen market conditions.

Background

The Trust was settled in 2001 as part of a management buy-out of a company. The beneficiaries were former and current employees of the company. The Trust was part-funded by subordinated debt which was repaid in 2011 from the holding company's profits. The trustee subsequently held 73% of the shares and received regular dividends, along with the other shareholders, from 2011 onwards.

In 2017, an offer was made to buy the entire share capital of the holding company. Before entering into the transaction, the trustee sought financial and legal advice with the objective of facilitating the holding of the shares by the beneficiaries, for their benefit. By clauses 5 and 7, respectively, of the trust deed, the trustee had discretion to apply capital or income from the assets to benefit the beneficiaries, but was restricted from disposing of any beneficial interest in the holding company shares if it would result in a loss of control.

Pursuant to section 57(1), Trustee Act 1925, and in reliance on the principles laid down in *Public Trustee v Cooper*[2], the trustee applied for the Court's approval to dispose of the Trust's entire shareholdings.

Held

In overruling the provisions of the trust deed, the Court ordered that the trustee's decision to proceed with the sale be approved. As the trustee had no power under the trust deed to approve the proposed sale, it could only be effected by the Court exercising its discretion. The trustee had received careful advice from both financial and legal advisers, so the sale of the shareholding, and subsequent winding up of the Trust, constituted "management and administration" of property. The trustee had considered the decision carefully, investigating the buyer thoroughly and the conflicts between the different classes of beneficiaries. The Court concluded that there would be significant benefits from the sale to the beneficiaries thereby fulfilling the express object of the Trust. The Court was of the view that it would be expedient to grant the trustee power to effect the sale transaction and that the requirements of section 57(1), Trustee Act 1925, were satisfied.

The Court considered whether the decision taken by the trustee fell within a range of reasonable decisions; the second limb of the test in *Public Trustee v Cooper*. Although the decision to sell the shareholding and thereby wind up the Trust was "momentous", the Court was of the view that despite a major change in the approach to the Trust's purpose, the trustee had the right to be flexible where continuing the Trust was likely to be less beneficial given the current market conditions. The trustee had carried out a structured and logical approach which considered more than just the financial considerations and the trustee's decision was not an unreasonable one.

1. [2018] EWHC 1064 (Ch).
2. [2001] WTLR 901.

Comment

Although each case will have to be determined on its own facts, but in circumstances where trustees need to respond to changing market conditions which were unforeseen when the trust was first established, they should consider whether it would be appropriate to make a similar application to the Court.

A copy of the judgment can be viewed here.

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Millar & Anor v Millar & Ors[3]

The principle established by the Supreme Court in *Marley v Rawlings and another*[4], that contradictory words in a will must be interpreted as framed by their surrounding factual context, has been applied for the first time by the High Court to a lifetime trust.

Background

The claimants were both the settlors and trustees of a lifetime trust. The settlement provided that should the main provisions of the trust fail, then funds would revert to the settlors. Specifically, clauses 4.2 and 5 of the settlement gave vested interests in reversion to the settlors and created a power of appointment exercisable in favour of the settlors, respectively. Clause 13 of the settlement applied notwithstanding any other provisions and provided that the settlors were to be excluded from any benefit.

The Court was required to identify the true intention of the settlors and to decide which clause was to prevail.

Held

The Court applied the principle of interpretation of commercial documents as set out in *Investors Compensation Scheme v West Bromwich Building Society* and *Rainy Sky SA v Kookmin Bank*[5]. In *Marley*, the Supreme Court confirmed that this principle of interpretation also applied to trusts and wills. The Court's task was therefore to identify the intention of the parties by identifying the meaning of the relevant words having regard to:

- the ordinary and natural meaning of those words
- the overall purpose of the document
- any other provisions of the document under consideration
- the facts known or assumed by the parties at the time that the document was executed, and
- common sense, but ignoring subjective evidence of any party's intentions.

Applying the above principle of interpretation, the Court decided that clause 13, which excluded the settlors from the benefit of the trust, should be disregarded.

Comment

In addition to being the first case in which this interpretive principle has been applied to a lifetime trust, *Millar* highlights the importance of careful will drafting. As the old adage goes, prevention is better than cure and this litigation may have been avoided if the original documentation had been drafted differently.

A copy of the judgment can be viewed here.

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3. [2018] EWHC 1926 (Ch).
4. [2014] UKSC 2.
5. [2011] UKSC 50.

Lewis & Ors v Tamplin & Ors[6]

The High Court has considered the extent to which beneficiaries are able to request information from trustees in relation to a trust and the application of legal professional privilege to any requested documents.

Background

Mr and Mrs Tamplin bought a farm as beneficial joint tenants. Following Mr Tamplin's death, Mrs Tamplin became the sole beneficial owner of the farm and created a trust dividing half of the equity in the farm between her six children (the Trust). Following Mrs Tamplin's death, her half share passed equally to her six children. Four of Mrs Tamplin's children died and their entitlements then passed to their children.

The two surviving children, Charles Edward Tamplin and Jane Wayne, were trustees and defendants in this case alongside Charles' son Mark Tamplin. Huw Lewis, Rhys Lewis and Sadie Lougher, children of Mrs Tamplin's deceased children, were beneficiaries to the Trust and claimants in this case.

The information sought by the beneficiaries included documents relating to option agreements as the farm had development potential and its value could exceed £10 million, correspondence from legal advisers and information relating to use and occupation of the land.

Despite the trustees refusing to disclose this information on the basis that the claimants were not beneficiaries, in County Court proceedings it was confirmed that the claimants were beneficiaries. The trustees provided a copy of trust accounts to the claimants which they considered to be inadequate.

The issues to be determined by the Court were:

- whether the trustees were required to disclose further information regarding their stewardship of the Trust, and
- whether any of those documents attracted legal professional privilege in which case they could be withheld from disclosure.

Held

The Court held that the beneficiaries were given insufficient information about dealings with the Trust's assets and authorised disclosure of the information sought by the claimants, but with certain exceptions.

The documents disclosed were to be restricted to trust documents concerning the beneficiaries, and not, for example, working papers belonging to advisers. The Court said that beneficiaries are only entitled to documents and advice protected by legal professional privilege, if those documents were created for the benefit of the trust and paid for out of trust funds. The beneficiaries are not entitled to documents which relate to the trustees in their individual capacity.

Similarly, beneficiaries are not entitled to ask trustees for an explanation or for the reasons behind their actions, they are only entitled to know how the trust assets have been dealt with.

6. [2018] EWHC 777 (Ch).

Comment

This case serves as a useful reminder that dissatisfied beneficiaries of a trust may apply to the Court for disclosure, or further disclosure, of information and/or documents concerning a trustee's stewardship of a trust. The judgment also provides helpful guidance on when documents will not be disclosed on the ground that they attract legal professional privilege.

A copy of the judgment can be viewed here.

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About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 83 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

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