Wealth and trusts quarterly digest

February 2018

Welcome to our latest wealth and trusts digest. Our quarterly digest provides up to date commentary and analysis 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

Avoiding the consequences of tax planning gone wrong

What happens when a trustee's tax planning goes wrong? The options available to trustees when they have made dispositions of property which do not produce the desired tax saving are limited. Trustees should ensure that they consider their options carefully and take professional advice to minimise the risks associated with complex tax planning. more>

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Trusts liable to UK taxes are now required to report information to HMRC which will be kept on a Trust Register. Guidance issued by HMRC outlines what needs to be reported, who needs to register and when registration is required. Professional bodies are seeking clarification on certain aspects as some of the guidance is at odds with the legislation. more>

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On 19 December 2017, HMRC updated its International Exchange of Information manual for recent developments affecting the Foreign Account Tax Compliance Act (FATCA), Common Reporting Standard (CRS) and the Directive on Administrative Co-operation (DAC) reporting. more>

New offshore tax offences

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Any comments or queries?

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The Court of Appeal has found that there was sufficient evidence to demonstrate that a property, and the proceeds of its sale, were held on a discretionary trust. more›

Feature

Avoiding the consequences of tax planning gone wrong

What happens when a trustee's tax planning goes wrong? The options available to trustees when they have made dispositions of property which do not produce the desired tax saving are limited. Trustees should ensure that they consider their options carefully and take professional advice to minimise the risks associated with complex tax planning.

The rule in *Hastings-Bass*

A trustee is under a duty to take into account relevant, and not irrelevant, matters when making decisions, including when making dispositions of property to achieve a tax saving. If they fail to do so, the relevant transaction is voidable and the court may set it aside under the so-called *Hastings-Bass*[1] rule.

The courts have recognised that trustees should usually take into account the tax consequences of a transaction when making decisions, although have warned there is a risk of tax "driving out" consideration of all other relevant matters.

However, the rule in *Hastings-Bass* only applies when a trustee has acted in breach of trust. It cannot be used where a trustee has relied on professional advice, even if that advice turns out to be wrong. The courts have also suggested that it would be for beneficiaries, rather than the trustees, to make an application to court to set aside a transaction on the basis of this rule.

Accordingly, if a prudent trustee has taken advice about tax consequences when making a decision, it will be difficult for the trustee to rely on the rule in *Hastings-Bass*.

Mistake

A transaction may also be set aside if the trustee has made a "causative mistake of sufficient gravity" about the consequences of the transaction. The court will consider the injustice and unconscionability of the mistake in deciding whether it is of sufficient gravity.

A mistake about the tax consequences of a transaction may be sufficient to set it aside, even if a trustee has taken professional advice. In *Pitt v Holt* [2013] UKSC 26, the Supreme Court set aside the disposition of property into a trust on the grounds of mistake, as it had been thought that this would have no tax effect whereas in fact the inheritance tax consequences of settling the trust were "a serious matter". In that case, the trust had not been drafted to meet the requirements for a trust for a disabled person under the inheritance tax legislation (an issue which professional advisers and the Court of Protection had failed to identify). The trust was exactly the kind of trust which Parliament had intended to benefit from tax relief, and the Supreme Court felt it would be unjust if relief was not granted.

However, the court indicated that in cases of "artificial" tax avoidance, transactions may not be set aside because a trustee, having received advice, must be taken to have accepted the risk that the arrangements may be ineffective.

As such, much will depend on the court's view of any injustice or unconscionability that would be caused if relief from the mistake is not granted. Trustees should not therefore assume that this option will be available to them if the tax planning does not produce the desired effect.

1. *Re Hastings-Bass* [1974] EWCA Civ 13, as clarified by the Supreme Court in *Futter and another v HMRC*; *Pitt and another v HMRC* [2013] UKSC 26.

Conclusion

It is very difficult for trustees to avoid the consequences of transactions which do not produce the desired tax result. As such, trustees should consider their options carefully and take professional advice to ensure that a course of action does not expose the trust to unnecessary risks.

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Trusts Register update

Trusts liable to UK taxes are now required to report information to HMRC which will be kept on a Trust Register. Guidance issued by HMRC outlines what needs to be reported, who needs to register and when registration is required. Professional bodies are seeking clarification on certain aspects as some of the guidance is at odds with the legislation.

Are you required to register?

UK express trusts and non-UK express trusts which incur liabilities to pay relevant UK taxes[2] in relation to UK trust income and UK assets will need to register. It is also possible that trusts such as complex deceased estates and collective investment schemes will need to register.

Trusts which do not incur a relevant UK tax liability, such as bare trusts, do not need to register. It is unlikely that charities will be required to register due to the availability of charitable tax exemptions.

When do you need to register?

Where a trust is already registered for self-assessment, registration must occur by 31 January after the end of the tax year in which the tax liability was incurred. A trust not registered for self-assessment which incurs income tax or capital gains tax liability for the first time must register by 5 October after the end of the tax year. Where a trust is liable to one of the other relevant taxes, registration must occur by 31 January after the end of the tax year.

How to register?

Registration is an online process. Trustees bear the responsibility of registration, but an agent can be appointed to register on their behalf.

Details required

Trustees are required to report the personal details of individual members of a class of beneficiaries if the beneficiaries exist and can be identified, even if they are not named in the trust documents or receive any distributions. Only where beneficiaries cannot be identified can a description of a class be reported.

Potential beneficiaries identified in a letter of wishes or other written document from the settlor must be reported, however, HMRC's guidance confirms that this does not extend to potential beneficiaries identified in a solicitor's attendance note.

Updating the register and penalties

Any changes to the information, or indeed confirmation of no changes, must be reported every tax year where a UK tax liability is incurred. Where no tax liability occurs, there is no requirement to update the register.

Details of a penalty framework that will apply to the trust registration service are awaited.

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2. Relevant UK taxes include income tax, capital gains tax, inheritance tax, stamp duty reserve tax, stamp duty land tax and Scottish land and buildings transaction tax.

HMRC updates International Exchange of Information Manual

On 19 December 2017, HMRC updated its International Exchange of Information manual for recent developments affecting the Foreign Account Tax Compliance Act (FATCA), Common Reporting Standard (CRS) and the Directive on Administrative Co-operation (DAC) reporting.

The changes are summarised below:

FATCA

- The Taxpayer Identification Number (TIN) to be reported for FATCA purposes is the US Federal TIN.
- The TIN is a mandatory item for reporting for FATCA in respect of pre-existing accounts for the 2017 reporting year onwards. However, in September 2017, the US Internal Revenue Service published Notice 2017-46, relaxing this requirement. The Notice confirms that foreign financial institutions (FFIs) in Model 1 IGA jurisdictions (including the UK) will not be in significant non-compliance with an applicable IGA during 2017, 2018, and 2019 solely as a result of a failure to report US TINs for pre-existing accounts, provided the FFI reports the account holder's date of birth, makes annual requests for the TIN, and searches its electronic records for missing US TINs before reporting information in relation to 2017.
- In view of the IRS Notice and the fact that UK Financial Institutions may find it difficult to obtain TINs for all US account holders, HMRC will not regard a failure by a UK Financial Institution to provide US TINs in respect of pre-existing accounts during 2017, 2018 and 2019, as a failure to comply with the UK regulations provided that the requirements of the Notice are met.

CRS and DAC

- When an account is closed, the Reporting Financial Institution must report the fact of the closure but is not required to report the balance or value of the account at closure. Any amounts paid or credited to the account in the reporting period up to the date of closure remain reportable.
- For Lower Value Pre-existing Individual Accounts and Pre-existing Entity Accounts, the due diligence had to be completed by 31 December 2017. This means that a Pre-existing Account could be closed in 2016 but not identified as a Reportable Account until 2017.
- The International Tax Compliance (Amendment) Regulations 2017, amended the reporting obligation so that a reporting financial institution must make a return for each calendar year setting out the information required to be reported under the relevant agreement in relation to:
  - each reportable account maintained during the calendar year in question, and
  - each pre-existing account identified as a reportable account during the calendar year in question.
- Therefore information in relation to an account closed in 2016 and identified as a reportable account in 2017 should be reported in the return for 2017 (due by 31 May 2018).
- This means that the return in respect of 2017 will include accounts still open at the end of 2017, accounts closed in 2017, and accounts closed in 2016 but not identified as reportable until 2017.

A copy of the updated manual is available to view here.

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New offshore tax offences

On 7 October 2017, new rules came into force creating three new strict liability criminal offences in relation to failure to disclose UK tax liabilities arising from offshore assets, income or activities, where the unpaid or underreported tax exceeds £25,000.

The specific new offences are:

- failing to notify HMRC of chargeability to income tax or capital gains tax
- failure to deliver a return when required to do so by a notice issued by HMRC, and
- filing an inaccurate return.

The new rules apply to tax years commencing 6 April 2017, which means the earliest an offence of failure to notify can be committed is 6 October 2018; for failure to file a return the earliest date is 6 April 2020; and for inaccuracy in a return, 31 January 2020.

Failure to comply may result in a fine or a prison sentence unless a taxpayer can prove that he took reasonable care or had a reasonable excuse for his non-compliance. The offences do not apply to trustees or personal representatives.

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Case reports

Barclays Wealth Trustees (Jersey) Ltd and another v HMRC[3]

The Court of Appeal has confirmed that inheritance tax (IHT) will not apply in circumstances where a transfer between excluded property settlements takes place after a settlor becomes domiciled in the UK.

Background

With certain exceptions, Chapter III of Part III, Inheritance Tax Act 1984 (IHTA), provides that settlements created by UK domiciled persons are "relevant property" and are subject to a charge at the time the trust is created, at each tenth anniversary, and when the property leaves the settlement, for example, by distribution. If the settlor retains an interest in the settlement, there will also be a tax charge on the settlor's death under the "gifts with reservation of benefit" regime. Certain property is exempt from these IHT charges, such as agricultural or business property.

Section 48(3)(a), IHTA, provides that where settled property is situated outside the UK, the property is "excluded property" for IHT purposes, unless the settlor was domiciled in the UK at the time the settlement was made. Where a foreign domiciled settlor establishes a settlement, but subsequently becomes UK domiciled (or deemed domiciled) and adds funds to that settlement, the question that then arises is whether those added funds are also excluded property. The date when the settlement was made can be crucial in determining liability to IHT.

Michael Dreelan (the appellant), was domiciled in Ireland and in 2001 he created a trust which was an "excluded property" settlement (the 2001 settlement). In 2003, he transferred shares in a UK company to the trustees of the 2001 settlement (the UK shares) who in turn held them through a Jersey resident company.

The appellant became deemed domiciled in the UK in 2008. He and his brothers subsequently created a new settlement (the new settlement) in which each brother had a lifetime interest. This settlement was a "relevant property" settlement.

The trustees of the 2001 settlement transferred the UK shares into the new settlement. The UK shares were deemed to remain in the 2001 settlement for the purpose of section 81, IHTA, however, they could not be considered "excluded property" because the appellant had become UK domiciled.

The trustees of the new settlement sold the UK shares and retained the proceeds. Thereafter, in 2011, the trustees of the new settlement transferred the appellant's share of the proceeds of sale to a Jersey bank. Accordingly, the proceeds were situated outside the UK.

HMRC issued Notices of Determination which were appealed.

Having been unsuccessful below, the appellant appealed to the Court of Appeal.

3. [2017] EWCA Civ 1512.

Held

In order to determine whether IHT was due in respect of the proceeds of sale held in Jersey, the Court had to determine whether the property held was “excluded property” and in order to decide that question it was necessary for the Court to consider whether the settlor was UK domiciled at the time the settlement was made (section 48(3)(a), IHTA).

The Court observed that there was no doubt that when the UK shares were originally placed in the 2001 settlement there could be no doubt as to the excluded property status of the shares.

When the UK shares were transferred in 2008 to the new settlement, they remained comprised in the 2001 settlement due to the effect of section 81, IHTA. Accordingly, when the proceeds of the sale of the UK shares were later appointed back to the 2001 settlement, as a consequence of the statutory wording, they remained comprised in that settlement.

When the proceeds of sale comprised part of the new settlement, they were not excluded property because (1) they were not non-UK property and (2) the appellant was UK domiciled. However, once the proceeds were transferred in to a Jersey bank the proceeds became non-UK property. Accordingly, the key question for the Court was whether the property was non-UK property at the time the settlement was made.

HMRC argued that the term must be considered at each point at which a transaction takes place. Accordingly, in its view, a settlement is made and re-made, for the purposes of the legislation, on each occasion a transfer takes place.

The Court disagreed with HMRC and said that “settlement”, for the purposes of IHT, is to be given its normal trust law meaning and accordingly a settlement is a single settlement irrespective of the number of transfers which are made into it. A settlement is created at the point at which the settlor first executes the trust instrument and provides the initial settled property.

As the appellant was not UK domiciled at the time when the 2001 settlement was created, the settlement remained an “excluded property” settlement for the purposes of IHTA and the appeal was allowed.

Comment

The consequence of this decision would appear to be that it is possible, in certain circumstances, to turn relevant property back into excluded property.

HMRC’s argument, if correct, would have created considerable complication for those wishing to transfer property between excluded property trusts in that it would have been necessary to consider the status of the settlor on each occasion on which a transfer took place. Given the Court’s judgment in this case, it would appear that this is not necessary.

A copy of the judgment is available to view here.

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Bing Holdings and another v Hue-Williams and others[4]

The High Court has dismissed a late notified application to amend the pleadings to include a claim for unjust enrichment on the basis that the parties had agreed a contract was in place and there was no good reason for the late application.

Background

Mr Hue-Williams (the claimant), was an art dealer. Mrs Chandris (the defendant), was a wealthy individual who owned an art collection, either individually, jointly with her husband Mr Chandris, or through their corporate vehicle.

Mr Chandris and the defendant retained the claimant's services in an art project to sell an existing collection and purchase a new modern art collection. The claimant claimed he was to be remunerated by way of commission in respect of the sale and purchase of the artwork.

In October 2011, two pieces of the art collection were sold and the claimant received his 5% commission as agreed. The claimant then provided his services by commissioning two new pieces of artwork and issued invoices to the defendant who declined to pay the invoices, but stated that Mr Chandris would.

In late 2012, the claimant was informed that Mr Chandris and the defendant were divorcing. The invoices had not been paid, but it was agreed that Mr Chandris would pay the invoices and the claimant would release the two artworks. A new company, Bing Holdings Ltd, was set up to buy the artwork and the claimant issued new invoices to the company. The project came to an end in 2013.

In 2016, Bing Holdings, commenced proceedings against the claimant, alleging breach of contract as payment had been made for the artworks but they had not been received. The claimant raised Part 20 claims against Mr Chandris and the defendant. Settlement was reached between Bing Holdings, the claimant and Mr Chandris. Therefore, the only claim left was the claimant's claim against the defendant which was the subject of the application.

The claimant claimed loss against the defendant calculated by reference to the remuneration he would have received had the project been completed, or, alternatively, a reasonable sum for the services in fact performed before the project was abandoned.

The application, which was heard one week before the trial was due to commence, sought to amend the claimant's pleadings to include a claim for unjust enrichment.

Held

The Court held that the amendment raised a new and distinct type of claim which could not be allowed and in any event the short notice would cause prejudice to the defendant. The correct approach in determining the application for an amended pleading at such short notice was to be found in *Quah Su-Ling v Goldman Sachs International*[5].

The relevant principles to be considered are:

- the discretion of the Court with reference to the overriding objective
- why it is just for all parties for the amendment to be pursued
- whether the trial date is to be lost

4. [2017] EWHC 3149 (QB).
5. [2015] EWHC 759 (Comm).

- the quality of the explanation given for the proposed amendment, the timing and delay of the application and a fair appreciation of the consequences
- the prejudice to the respondent, not just in terms of costs compensation, and
- a strict view of non-compliance with the CPR and directions of the Court to ensure litigation is conducted to obtain justice efficiently and proportionately.

In a claim for unjust enrichment the Court must ask itself the following four questions:

- has the defendant been unjustly enriched?
- was the enrichment at the claimant's expense?
- was the enrichment unjust? and
- are there any defences available to the defendant?

The Court held that the lateness of the application allowed insufficient time before trial for the defendant to consider and plead the new point if the amendments were allowed. The amendments could not be fairly allowed without adjourning the trial.

Notwithstanding the procedural findings, the Court said that the application would have been dismissed in any event because the amendment would only be relevant if it was found there was no relevant contract between the parties and this was not the case as the parties agreed there was a contract.

Comment
This case provides an important reminder of the principles which the courts will consider when determining an unjust enrichment claim. Where there is a contract between the parties, it is unlikely that a claim for unjust enrichment will succeed. Additionally, the judgment highlights the difficulties faced by applicants who make applications to amend their pleadings shortly before the trial date.

A copy of the judgment is available to view here.

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(1) Jane Rebecca Ong (2) Alexander Ong (3) Nicholas Ong (4) Jordana Ong (Respondents/Claimants) v Ong Siauw Ping (Appellant/Defendant)[7]

The Court of Appeal has found that there was sufficient evidence to demonstrate that a property, and the proceeds of its sale, were held on a discretionary trust.

Background
The claim related to a property situated at 39 Sheldon Avenue, London (the property) and its proceeds of sale.

Madam Lim, who died in 2009, had bought the property in 1986. She had at all material times been domiciled outside the UK, and a firm of solicitors had acted for her on the purchase of the property. Contracts had been exchanged on 14 December 1985, when she expressed an intention to establish a trust of the property for the benefit of her grandchildren, the second, third and fourth respondents, on terms to be decided.

6. [2013] UKSC 30.
7. [2017] EWCA Civ 2069.

The purchase was completed in January 1986 and Madam Lim was registered as sole proprietor. Shortly thereafter, her solicitors advised her that she had purchased the property as the trustee of a trust established on 14 December 1985. It was common ground that this was incorrect and that no trust had been established on that date. The solicitors sent a draft trust deed to Madam Lim in February 1986. Its sole recital was that she wished to make an irrevocable settlement of the property "specified in Sch.1". Schedule 1 described the settled property as "the sum of [blank] pounds", and the property was not referred to. Following an exchange of correspondence, Madam Lim sent a signed copy of the trust deed to her solicitors on 14 April 1986. Although she had been told to enter the amount of the gift in Schedule 1 she did not do so. On the face of it, therefore, the signed trust deed declared trusts in respect of nothing.

In May 1988, Madam Lim wrote to her solicitors indicating that she wished to cancel the trust, and in 2006 she sold the property. After her death, the respondents obtained a declaration that she had declared a trust of the property in April 1986 and that the proceeds of sale were held on the same trust. The judge found that it was Madam Lim's express wish that she would hold the property on the basis of a trust; that on 14 December 1985 there was clarity as to the intended beneficiaries; that the terms of the trust became defined on 14 April 1986; and that although Schedule 1 did not define any trust property, she had executed the deed intending the property to be trust property.

The respondents appealed to the Court of Appeal.

The issues to be determined by the Court of Appeal included whether a valid trust under Jersey law had been created in respect of the property in circumstances where the executed trust instrument had not specified any trust property and, if so, whether its existence was deliberately concealed from the Court.

Held
The appeal was dismissed.

The Court found that there had been a valid declaration of trust in respect of the property. Although Madam Lim had made no express oral declaration of trust, this was not essential for the creation of a trust by way of a declaration. There simply had to be clear evidence of an intention to create a trust from what was said or done; *Paul v Constance* [1977] 1 WLR 527 was followed. The Court questioned whether a reasonable person would infer that Madam Lim was declaring a trust of the property by signing the trust deed and concluded that if the trust deed and Madam Lim's accompanying letter were considered together, such an inference could be drawn (although on the face of the deed there was no trust property). Additionally, a reasonable person would be entitled to consider the background circumstances, including the correspondence leading up to the signing of the deed, which demonstrated that her intention had always been to subject the property to a trust for the benefit of her grandchildren.

Although something appeared to have gone wrong with the drafting of the settlement, Madam Lim intended the property to be held on trust. Given her solicitors' advice, she would have understood that a trust of the property had been established and would be governed by the deed (even though the deed did not mention it). Having read the correspondence, a reasonable person would have no difficulty in understanding how she might have reached that view. Although her solicitors must have seen that the signed deed did not refer to the property, they did not advise her that anything more had to be done and did not explain why she should refer to a sum of money in Schedule 1. A reasonable person would infer that she had not done so because she wanted to execute a deed that would result in the property becoming a trust asset, and they would find it unremarkable that she should think that the property would automatically become subject to the trusts when she signed the deed.

Comment

This case is a timely reminder that great care needs to be taken when creating a trust. In particular, although a court may be prepared to find that a trust was created if there is clear evidence before it of an intention to do so from what was said or done, it is preferable if the trust is formally documented in order to minimise the risk of future dispute.

A copy of the judgment is available to view here.

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About RPC

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