TRUSTEES

Trustees: Mistaken loyalty

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> ***The claimant's acceptance of her appointment could be severed from the DORA without offending the rule against partial rescission and without operating unfairly on any other party.***

This article considers some of the practical implications of the recent decision of the High Court (on appeal) in *Mackay v Wesley* [2020], which set aside the claimant's (Mrs Mackay's) acceptance of her appointment as a trustee of an offshore trust on the ground of undue influence. The decision at first instance of Deputy Master Henderson (overturned on appeal) dismissed the claim on all four grounds advanced, including mistake, and the Deputy Master's analysis on that ground (which was not engaged with by the appeal judge) represents a significant development to the mistake jurisdiction. This article reviews the findings of the Deputy Master and considers how they may be treated by the courts in the future.

Background

On 19 March 2003, Mrs Mackay, a teacher, signed the signature page of a document at the request of her father, Mr Wesley. Eight years later, she received a letter from HMRC seeking payment of around £1m in unpaid capital gains tax (CGT). It was only then that she learnt that the document she had signed was in fact a deed of appointment and retirement (the DORA) appointing her as a trustee of an offshore trust (the trust). She had been asked to sign it so that (unbeknown to her) the trust could implement a tax scheme designed to avoid CGT (known as a 'Round the World' scheme). Her co-trustees were Mr Wesley (described by the Deputy Master as now virtually penniless) and a trust company affiliated to Browne Jacobson, the law firm involved in advising on the arrangements (Browne Jacobson Trustees Ltd (BJTL), since put into liquidation after having initially taken conduct of the appeal against the HMRC assessment). Mrs Mackay therefore found herself as the principal target of HMRC's enforcement action. By the time of the appeal the amount sought by HMRC was over £1.6m including interest.

The tax planning had been implemented by the former trustee of the trust on professional advice. It related to the sale of shares in a family company, the major asset of the trust fund, having an approximate value of £3.6m. The 'Round the World' scheme, a variant of which was considered by the Court of Appeal in *HMRCC v Smallwood* [2010], was implemented broadly as follows:

- The trustees of the trust were originally resident in the Isle of Man. They retired in favour of new Mauritian trustees, such that the trust would become Mauritian-resident for tax purposes.
- The Mauritian trustees disposed of the shares and distributed the proceeds to UK beneficiaries.
- UK trustees were then appointed in place of the Mauritian trustees within the same UK tax year of assessment.

In very broad terms, the scheme sought to rely on the fact that under a combination of the UK legislation at the time and the UK-Mauritius double tax treaty, the gain would be taxable only in Mauritius, not the UK, but Mauritius did not tax capital gains – as a result, the intention was that the gain on the shares would be free from tax.

By the time the DORA was executed, the Mauritian trustees had already disposed of the bulk of the trust assets to other trusts, for the ultimate benefit of Mr Wesley, such that little more than £60,000 remained when Mrs Mackay was appointed as trustee.

Mrs Mackay's unchallenged evidence was that Mr Wesley, as the head of the family and a successful businessman, would regularly ask Mrs Mackay to sign documents relating to the family finances. As his daughter, with no financial experience, Mrs Mackay trusted Mr Wesley implicitly and did not feel able to challenge his authority. Mrs Mackay did not realise what she was signing when she executed the DORA but assumed that her father would not ask her to sign something that exposed her to substantial personal liability. She did not receive any professional advice (nor was she recommended to obtain any) prior to signing the DORA. The execution of the DORA also coincided with an extremely distressing and traumatic period in Mrs Mackay's life. She had, only a few weeks earlier, experienced an exceptionally difficult pregnancy. Her mother was also terminally ill and required full-time care, principally from Mrs Mackay, and died a few months after the DORA was executed.

Unbeknown to the claimant, HMRC opened an enquiry into the tax return of the trustees for the relevant tax year, culminating in HMRC issuing a closure notice in 2011, the effect of which was that tax of approximately £1m was demanded. The trustees appealed the closure notice; after some procedural irregularities the appeal was eventually heard before the First-tier Tax Tribunal in January 2020. At the date of writing, the decision of the Tribunal is pending.

The claim

In July 2019 Mrs Mackay brought a claim against Mr Wesley (as her sole remaining co-trustee) to have her appointment as trustee under the DORA set aside on the grounds of undue influence, mistake, lack of capacity or *non est factum*. Mr Wesley did not oppose the claim or file an acknowledgement of service; however, he wrote to the court confirming that Mrs Mackay's evidence was accurate in all material respects.

HMRC was informed of the claim and provided with the statements of case and witness evidence. HMRC took no steps until a week before the hearing, when it wrote a detailed letter to the court opposing the claimant's evidence and some of the legal arguments. It did not apply to be joined as a party.

Hearing the claim at first instance, Deputy Master Henderson accepted Mrs Mackay's evidence, and attached no weight to HMRC's opposition to it, commenting that if HMRC had wished to comment on the evidence then it should have applied to be joined as a party. Nevertheless, the Deputy Master dismissed the claim on all four grounds advanced. Central to his reasoning were his findings that:

- a person's appointment as trustee and their acceptance of that appointment are two distinct events, with the trusteeship becoming effective on the appointment (and not the acceptance); and further
- the appointment of Mrs Mackay as trustee was a unilateral act by the outgoing Mauritian trustees. Accordingly, he held that the appointment could not be set aside for undue influence or mistake as the Mauritian trustees had not acted under undue influence or a mistake when appointing Mrs Mackay as trustee.

On the ground of mistake, the Deputy Master held that, in addition to the above, Mrs Mackay's belief that her father would not ask her to sign documents that would put her in danger was an 'insufficiently distinct' mistake to engage the equitable doctrine as set out in *Futter v HMRCC (with Pitt v HMRCC)* [2013]. Further, her appointment as trustee was not a disposition of property by her, which was required for the *Pitt* principles to be engaged.

On any of the above grounds, the Deputy Master also held that rescission of the claimant's appointment from the DORA would fall foul of the rule that there can be no partial rescission of a contract.

The appeal

Mrs Mackay was granted permission to appeal and to amend her statements of case to include an alternative plea, following the reasoning of the Deputy Master, that her acceptance of the appointment as trustee be set aside on the same grounds. The appeal was heard before Meade J, who, allowing the appeal, ordered that Mrs Mackay's acceptance of her appointment as trustee under the DORA (on her alternative case) be set aside on the ground of undue influence. The judge did not address the Deputy Master's arguments on the ground of mistake, which he considered to be complex and potentially important, and better decided in a context where both sides were fully argued. The judge held the claimant's acceptance of her appointment could be severed from the DORA without offending the rule against partial rescission and without operating unfairly on any other party.

Points of interest

Appointment as trustee

Following the decision on appeal, it remains unclear whether acceptance is a necessary element of an appointment as trustee. Meade J set aside Mrs Mackay's acceptance of the appointment, rather than the appointment itself, although he did comment on the Deputy Master's analysis on this point. Where the Deputy Master had relied on s36 Trustee Act 1925 and *Mallott v Wilson* [1903] in support of his finding that an appointment was a

unilateral act which could be accepted or disclaimed, the judge held (citing *Evans v John* [1841] and *Scott v Bridge* [2020]) that the essential duties of a trusteeship (to collect and safeguard the trust property) could not be imposed on a person without their knowledge or consent, even provisionally. Nevertheless, it was Mrs Mackay's acceptance of the appointment which was set aside and so Meade J's comments may be viewed as *obiter*, in which case the Deputy Master's findings at first instance have not necessarily been overturned (albeit doubted). This would represent a significant clarification of the law on trusteeship and the manner by which a trustee is appointed.

Mistake claims

The Deputy Master's findings on mistake, which were not addressed by the judge on appeal, constitute perhaps the most important ramifications of *Mackay*. Of particular significance is the Deputy Master's finding that Mrs Mackay's execution of the DORA was not a mistake of the relevant kind. By way of reminder, the principles for setting aside a non-contractual voluntary disposition for mistake are set out in *Pitt*. For the doctrine to apply:

- there must be a distinct mistake, which may be established by an inference of conscious belief or tacit assumption, as distinguished from mere ignorance;
- the mistake may still be a relevant mistake even if due to carelessness, unless the person making the disposition can be shown to have deliberately run the risk;
- the mistake must be 'of so serious a character as to render it unjust on the part of the donee to retain the property given to him' (*Ogilvie v Littleboy* [1897]); and
- the injustice of leaving a mistaken disposition uncorrected must be evaluated objectively but with an intense focus on the facts of the particular case.

As noted above, the Deputy Master considered that Mrs Mackay's belief that her father would not ask her to sign documents that would put her in danger was insufficiently distinct from mere ignorance. In doing this, the Deputy Master distinguished Mrs Mackay's mistake from cases such as *Freedman v Freedman* [2015], *Hartogs v Sequent (Schweiz) AG* [2015], and indeed *Pitt*, where he determined there had been a specific belief that the arrangements would not have adverse tax consequences.

Comparing the facts of this case against *Pitt*, the distinction between the nature of Mrs Mackay's mistake and that made in *Pitt* is exceptionally fine. Mrs Pitt had not considered the possibility of inheritance tax arising on the trust she established because her advisers had not alerted her to it. Similarly, Mrs Mackay had not been alerted to the fact that the document she was asked to sign formed part of a tax avoidance scheme. It will be interesting to see how the courts will apply this limb of the *Pitt* doctrine to future claims based on mistake, and what mistakes will be treated as sufficiently or insufficiently distinct.

Also of importance are the Master's ancillary findings that the appointment of Mrs Mackay as trustee in the DORA was not a disposition for the purposes of the mistake jurisdiction, as the appointment of Mrs Mackay (or her acceptance of it) was not disposition of property, nor a voluntary transaction (see the first limb of the *Pitt* test above). However, there is case law in which acts which do not constitute a disposition of property (a consent to a change of pension scheme rules) have been set aside on the ground of mistake: *AMP (UK) Ltd plc v. Barker* [2001]. On the second, in our view, it is questionable whether the covenants of indemnity given by Mrs Mackay in the DORA amounted to real and substantial

consideration to the outgoing Mauritian trustees such that the transaction was not voluntary (as the Deputy Master found). Arguably, these indemnities are not consideration but practical arrangements made for the benefit of the beneficiaries, that are typically a prerequisite in deeds replacing trustees of a trust. If the Master's decision is correct on this ground, it would seem that the mistake jurisdiction can have no or limited application to an appointment as trustee, where it is made in replacement of incumbent trustees. It will be interesting to see if this point is tested in future cases.

Practical implications

Availability of equitable remedies

The case is a good example to individuals, fiduciaries and practitioners alike of the importance of considering equitable remedies when faced with unexpected consequences (and in particular, tax consequences) of arrangements or planning made possibly several years previously. On Mrs Mackay's amended case, the court (on appeal) was readily prepared to set aside Mrs Mackay's acceptance of her appointment as trustee based on the evidence of undue influence from her father. Both the Deputy Master at first instance and the judge on appeal commented expressly that they did not consider the consequences of the relief in the parallel proceedings in the tax tribunal (ie that Mrs Mackay would no longer be a party to the proceedings brought by HMRC to enforce the tax liability) constituted any unfairness to prevent them from rescinding Mrs Mackay's acceptance of her appointment (albeit for the Master there were other bars preventing him from granting this relief).

Equitable remedies typically offer a potential claimant a quicker and cheaper means (as against fully contested proceedings) of obtaining relief from the court, as the claims are often uncontested (as was the case here) and can usually be made through the more streamlined Part 8 process under the CPR. However, such applications are not always straightforward and can fall short on highly technical grounds, as this one did at first instance. As such, it is advisable to instruct counsel with extensive experience of applications of this nature (as well as experience of tax claims and dealing with HMRC, where appropriate) to give the application the best possible chance of success.

Anyone faced with such an unexpected tax liability should also consider associated professional negligence claims against the professionals who advised on the unsuccessful arrangements or planning. Any such claim however will almost invariably be more onerous from a time and costs perspective, and potentially difficult from a relationship or reputational standpoint. In this case, Mrs Mackay began a claim against the legal advisers to the trustees at the pre-action stage but had to discontinue it due to lack of funding. Finely balanced strategic questions need to be considered when it comes to pursuing such claims in the context of a potential application seeking an equitable remedy. For example, the claimant may seek a contribution towards their costs of the application from the negligent advisers, and careful consideration should be given to whether bringing such a claim falls within the scope of the duty to mitigate loss in any professional negligence proceedings.

Communication with HMRC

As with any claim relating to an unexpected tax liability, HMRC should be notified at an early stage and invited to make submissions that they wish to be brought to the attention of the court. HMRC will often indicate that it does not wish to participate in the proceedings and asks that the parties put the relevant case law (for example *Pitt*) before the court. Alternatively HMRC may apply to be joined as a party to the claim (as it did in *Pitt*) where it contests the application, although it has done this less frequently in recent years. The events that transpired in *Mackay* were unusual in that HMRC (at a very late stage prior to the hearing) submitted a detailed letter to court expressing opposition to Mrs Mackay's claim (citing among other things the concurrent tax appeal in the First-tier Tax Tribunal) but without applying to be joined as a party. The Deputy Master at first instance commented that while the court should take into account whatever HMRC has to say, and he had found some of the legal arguments raised by HMRC to be helpful, he had not found it helpful that HMRC had made allegations regarding Mrs Mackay's evidence without seeking to be joined to the proceedings or challenging that evidence in cross-examination, and accordingly accepted Mrs Mackay's evidence as unchallenged.

The above demonstrates that parties bringing applications for equitable relief with tax implications should prepare themselves for engagement by HMRC at any stage in the proceedings, however late, and ensure that HMRC is kept up to date at all times.

Implications for trust practitioners and advisers

This case is an important reminder for trust practitioners and their advisers to ensure that all necessary steps are taken to ensure that any persons (in particular lay persons) agreeing to be appointed as a trustee are properly advised as to the responsibilities and obligations imposed by a trusteeship and to satisfy themselves that there is no risk of undue influence from any party. In this regard the principles of *Royal Bank of Scotland plc v Etridge (No. 2)* [2002] are relevant and provide important guidance for practical steps which a practitioner would be expected to take. For example, it is suggested it is essential to ensure that the person taking on the trusteeship has been informed of their duties and obligations as trustee, as well as the nature and extent of their potential liabilities (including personally), and in most cases the potential trustee should be recommended to obtain independent legal advice on these matters.

If proper steps are not taken then the appointment may be vulnerable to rescission on grounds including but not limited to mistake and undue influence. That may have significant implications for any remaining trustees against whom liabilities for tax or otherwise may be recovered. In all likelihood it will also give rise to a claim in professional negligence against the advisers who failed to take the necessary protective steps for the full liability arising, which may be significant.

Cases Referenced

- AMP (UK) Ltd plc v Barker [2001] WTLR 1237 ChD
- Evans v John (1841) 4 Beav. 35
- Freedman v Freedman & ors [2015] WTLR 1187
- Futter v HMRCC (with Pitt v HMRCC) [2013] WTLR 977 SC
- Hartogs v Sequent (Schweiz) AG [2020] WTLR 505 ChD
- Mackay v Wesley [2020] EWHC 3400 (Ch)
- Mallott v Wilson [1903] 2 Ch 494
- Ogilvie v Littleboy (1897) 13 TLR 399
- Royal Bank of Scotland plc v Etridge (No 2) [2001] UKHL 44
- Scott v Bridge [2020] EWHC 3116 (Ch)
- Smallwood v Revenue & Customs Commissioners [2010] WTLR 1771, [2010] EWCA Civ 778

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