The Personal Tax Planning Review

THE GHOSTS OF SETTLEMENTS PAST

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The question which I aim to answer in this article is:

> *Will a trustee be liable to the Inland Revenue qua trustee of a settlement after he has retired from the position of trustee?*

Briefly, my answer is necessarily equivocal. All depends upon the stage in the three-limbed process, which I shall describe, in which the trustee finds her/himself. The three stages for the trustee are:

1. The pre-trustee stage; or

2. Where the trustee has been appointed a trustee by a valid appointment but not discharged; or

3. Where the trustee has been discharged from the office of trustee.

As I shall demonstrate, it is necessary to fix the trustee in one of these time slots to decide upon her/his liability, subject to the "extraordinary" liability which the caselaw imposes in particular cases.

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Before Appointment to the Office of Trustee

Section 36 TA 1925 contains the procedure for the appointment of a new trustee to a settlement. Due to the very technical nature of the section it is not proposed to set out the section in full here. In short, unless s.36 is complied with, an individual will not become a trustee. No liability will therefore attach to an individual before being made a trustee for any breach of trust. The exception may be where a constructive trust is imposed upon her/him (as in *Lloyds Bank v Rossett*[2] circumstances) or where that individual has facilitated a breach of trust such that he is deemed to acquire some form of fiduciary capacity (at which point "constructive trusteeship" is imposed, see *re Montagu*[3]).

The position with reference to liability to the Inland Revenue is interesting. What would be the liability of a constructive trustee for any income accruing to the property which she/he is deemed to hold on trust while she/he has it in her/his possession?

Notably, this point would apply also to those trustees who had been validly discharged from their trusts, within the meaning of the TA 1925, who were found to be constructive trustees.

There does not appear to be a categoric answer to the question. In practice, I suppose that the ultimate, that is the rightful trustees, would be liable to the Revenue. In law, however, there is no reason why the constructive trustee should not be liable.

Trustees who have been Validly Appointed to, but not Discharged from, the Office of trustee

Where a trustee has been validly appointed, the general principles of the taxation of trusts applies to them. That is to say that tax will be leviable on the trustees although the charge is in fact on the trust and not on them in a personal capacity. In the case of a bare trust, the charge is imposed on the trustee but is in fact met by the beneficiary's fund.

The trustee is unable to use any personal allowances or exemptions to mitigate this tax.

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2 [1989] AC.

3 [1989] AC.

The only instance in which liability will fall on a trustee personally is where that trustee has been guilty of a breach of trust (*Bartlett v Barclays Bank* [4]). Liability for breach of trust is a personal liability on any individual trustee. It is the case that trustees are jointly and severally liable for all breaches of trust. Therefore if the breach of trust consists of paying away the whole of the fund such that there were no funds left to meet the liability to tax on the settlement for the year of assessment, the trustees would be jointly liable but open to attack severally to recover what is a chose in action against them in a personal capacity. In this circumstance, the liability to pay the tax **is** therefore a personal liability.

The only situation in which the trustee may be discharged from any liability to account in this way would be the situation where all the beneficiaries, acting *sui juris* and absolutely, provided the trustee with a formal release from the trusts.

> "...the only person who can give, or is called upon to give, a formal release to a trustee is a beneficiary when the whole trust is brought to an end."[5]

Trustees cannot grant a release to other trustees because of the "very difficult position in regard to beneficiary who claimed that his rights had been damaged."[6]

Therefore, in the absence of any formal release of the trustees by the beneficiary at the end of the trust, the trustee must have been discharged from the trusts within the terms of the TA 1925 [7] for his trusteeship to have come to an end.

The question is then one of deciding in the particular case whether or not the settlement has come to an end. It may be that one settlement has ended and another been created. The best example of this is explained by Lord Wilberforce in *Roome v Edwards* [1981] STC 96 at 100 d-g:

> "...the trusts declared by a document exercising a special power of appointment are to be read into the original settlement (see *Muir v Muir* [1943] AC 468). If such a power is exercised, whether or not separate trustees are appointed, I do not think that it would be natural for such a person as I have pre-supposed to say that a separate settlement had been created, still less so if it were found that provisions of the original settlement continued to apply to the appointed fund, or that the appointed fund were liable, in certain events, to fall back into the rest of the settled property. On the other hand, there may be a power to appoint and

4 [1980] Ch.

5 *Tiger v Barclays Bank* [1951] 2 KB 556 at 561.

6 *ibid* .

7 For example, under the terms of s.41 or s.36 and the attendant caselaw.

> appropriate a part or portion of the trust property to beneficiaries and to settle it for their benefit. If such a power is exercised, the natural conclusion might be that a separate settlement was created, all the more so if a complete new set of trusts were declared as to the appropriated property, and if it could be said that the trusts of the original settlement ceased to apply to it. There can be many variations on these cases each of which will have to be judged on its facts."

His lordship shows the well-known difficulties involved in deciding whether or not a trust has come to an end or been transferred onto other trusts. Suffice it to say for these purposes that deciding whether or not another trust has come into existence is only the beginning: it still begs the question who will be liable for the tax owed by the trust. The decision will have to be made as to whether or not the trustee has been validly appointed or whether the trustees of the previous trust will be liable. From the point of view of common sense, it must be the case that the tax liability of separate trusts cannot be transferred between trusts. On this, I refer the reader to the next section.

Where the Trustee has been Validly Discharged form the Office of Trustee

There are two separate issues here. The first is the role of the remaining/continuing trustees and their liability for the defaults of the previous trustees. Were they to be liable, it would enable any Revenue claim against the trustees for tax to be discharged by bringing an action against the present trustees *simpliciter*. This would leave the present trustees with a potential claim against the old trustees personally to indemnify their descendants against the Revenue's claim; see *White v Vandervell's Trustees* 46 TC 341.

It may of course be possible for the new trustees to argue that a new settlement has been created where the facts bear this out and therefore prevent the liabilities of old trusts carrying over to them; *Roome v Edwards* infra.

It was countenanced in *Roome v Edwards*, in the less publicised second limb of Lord Wilberforce's judgment, that one set of trustees can be liable for the acts and defaults of another set. It is perfectly possible that a court would seek to confine this limb of the judgment to its particular facts. Those facts were, of course, that a trust had been established with trustees, ultimately, in both the United Kingdom and the Cayman Islands. The concept of the personality of the trustees as a "single and continuing body of persons" was considered by the Revenue to enable them to argue that a disposal by the Cayman Islands trustees could still lead to a charge to capital gains tax being levied on the United Kingdom trustees. Lord Wilberforce felt that the possibility

> "that one set of trustees may be charged to tax in respect of the transactions of another set of trustees over which they have no control does not appear

> attractive in principle, however little practical hardship may arise in some cases and indeed in the present case."[8]

Therefore, in principle, one body of trustees can be liable for the taxable acts of another set of trustees over which they have no control, provided that they are subject to the same trusts. Therefore, from the Revenue's point of view, they can proceed against the present trustees for tax owed by the previous trustees.

This may be particularly significant in a situation where the original trustees have extracted a formal release from the beneficiaries, particularly if the extraction of such a release was part of their contractual inter-action. It may be that such a term of any contract governing the appointment and remuneration of the professional trustees would be held to be invalid under the Unfair Contract Terms Act 1977. And, in any event, the professional trustee would have to meet the requirement in *Tiger v Barclays Bank* that the trust be at an end for such a release to be given. In favour of the trustees here is the apparent difficulty in justifying a restriction on the beneficiaries acting *sui juris* and absolutely from granting a valid release during the life of the trust. By analogy with the principle in *Saunders v Vautier*, the beneficiaries could dissolve the trust and start again.

However, this was an argument which did not commend itself to Vaisey J in *re Brockbank*[9], partly on the basis that if the beneficiaries chose to take the *Saunders v Vautier* route they would have to suffer the tax consequences of that. That being the sole objection, it is difficult to see why, in principle if not in practice, the beneficiaries should be prevented from granting a formal release. That must be a matter between themselves and their professional advisers.

The danger is that, in any event, if the beneficiaries purport to grant a formal release to trustees, it may be deemed that a new settlement has been formed under the stewardship of the new trustees given that a formal release is only valid when the trust has come to an end.

Under s.37(1)(c) TA 1925, a trustee cannot be discharged from the position of trustee unless there are two trustees or a trust corporation left in place after his discharge. Read together with s.39 TA 1925, this appears to be determinative of the situation in which a trustee can cease to be liable for any of the acts or omissions of the continuing body of trustees.

On the caselaw, I shall seek to draw a distinction between liabilities for breach of trust which are personal to the trustee and liabilities for taxation which are imposed on the trustee *qua* trustee and not in any individual capacity.

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8 *ibid* at page 102 f-g.

9 [1948] Ch.

The second question is whether or not the Revenue can pursue the trustees who have retired. There is no caselaw directly in point so one must tease principle from the body of cases on the liability of trustees generally and the liability of retired trustees in particular.

If liability for breach of trust attaches to trustees personally (*Bartlett v Barclays Bank*) there is no question of the trustee's discharge absolving her/him from liability under the terms of the trust. The question with reference to taxation is different, however, in that taxation attaches to bodies of trustees (Lord Wilberforce in *Roome v Edwards* and see also s.69(1) TCGA) rather than to individual trustees or to settlements. Therefore, if the liability attaches to the "body of trustees", there can be no personal liability to tax leviable on the individual who has retired from the position of trustee. It is only if the trustee has committed some actionable breach of trust that the continuing trustees can recover anything from the individual personally.

The case of *Head v Gould*[10] is pertinent in this context. It countenanced the possibility that the very act of retiring, in the knowledge that the remaining trustees would commit a breach of trust, would of itself constitute a breach of trust. At page 268 Kekewich J says:

> "It is the duty of trustees to protect the funds intrusted [sic] to their care, and to distribute those funds themselves or hand them over to their successors intact, that is, properly invested and without diminution, according to the terms of the mandate contained in the instrument of trust. This duty is imposed on them as long as they remain trustees and must be their guide in every act done by them as trustees. On retiring from the trust and passing on the trust estate to their successors - and this whether they appoint those successors or merely assign the property to the nominees of those who have the power of appointment - they are acting as trustees, and it is equally incumbent on them in this ultimate act of office to fulfil the duty imposed on them as at any other time. If therefore they neglect that duty and part with the property without due regard to it, they remain liable and will be held by the Court responsible for the consequences properly attributable to that neglect."

Therefore a trustee can be held personally liable for a breach of trust simply by dint of the act of retiring. However, this does not alter the fact that once the process of discharge has been perfected, no liability attaching to present trustees can attach to that ex-trustee.

The only way in which the statement in *Bartlett v Barclays Bank* that liabilities for breaches of trust are personal as against trustees past and present can be reconciled

[10] [1898] 2 Ch 250.

with the assertion in *Williams v Singer*[11] is that the tax liabilities of settlements are imposed on trustees otherwise than in their personal capacities. Taxation liabilities must always be actionable against trustees who have been appointed but not discharged. Breaches of trust attributable to individual trustees are personal in nature and subsist despite a valid discharge from the office of trustee after or in full contemplation of the breach of trust.

This analysis seems to be watertight but for two Capital Transfer Tax cases: *IRC v Stype Investments*[12] and *IRC v Stannard*[13]. In the former case, Templeman LJ allowed the English courts jurisdiction to hear the case even though the trustees were a Jersey trustee company, on the basis that the company:

> "voluntarily came to England, accepted a conveyance of English land as nominee for [the deceased] and, if the Inland Revenue are correct, incurred personal liabilities to the Crown for capital transfer tax..."

Both decisions centred on s.25 Finance Act 1975 which provided, in short, that "the persons liable [for capital transfer tax]...are the deceased's personal representatives". The cases therefore categorised the liability for the tax as being the personal liabilities of the personal representatives. However, such was only the case because of the express statutory provision to that effect. The existence of the statute of itself assumes that the personal representatives would have had no personal liability for the tax but for the existence of the provision. In the absence of any such provision therefore, it appears that the foregoing analysis holds good.

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11 7 TC 387.

12 [1982] STC 625.

13 [1984] STC 245.