HERBERT SMITH FREEHILLS

HIGH COURT OFFERS SYMPATHY BUT NO REMEDY TO TRUSTEE FACING UNEXPECTED TAX BILL

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Legal Briefings

In *Mackay* v *Wesley* [2020] EWHC 1215 (Ch), the Claimant, who was instructed by her father to become a trustee of a family trust as part of a tax scheme, failed to obtain from the High Court (1) an order rescinding her appointment as trustee and/or (2) a declaration that she never became a trustee. The decision underlines the difficulty of "reversing" a multilateral transaction (even in circumstance where the Court's sympathies are with the claimant), and the need to adduce cogent evidence where such a reversal is sought.

BACKGROUND

Where HMRC assert that a transaction has given rise to adverse tax consequences, there are usually at least two courses of action to consider. The first course of action involves accepting that the transaction took place, but challenging HMRC's view as to how it should be taxed. This is what happens in a common or garden tax appeal to the First-tier Tribunal (the "**Tribunal**"). The second course involves "reversing" the transaction in order to avoid the adverse fiscal consequences.

Although it is possible to follow both courses of action in a single tax appeal, it is not uncommon (and it is frequently advantageous) to bifurcate the challenges, with a tax appeal and High Court claim for relief running concurrently or consecutively. In *Mackay*, an appeal and claim were run concurrently.

There are various remedies which may be sought where a litigant seeks to reverse a transaction, and there are various grounds which may be advanced to secure those remedies. In *Mackay*, the claimant offered the High Court a panoply of grounds in support of a claim for rescission or declaratory relief. Unfortunately for the claimant, each ground was dismissed and, accordingly, relief was refused. The Court's decision is considered in detail below.

FACTS

The Claimant (Mrs Mackay) was, together with a number of family members including her father (the Defendant, Mr Wesley), a beneficiary of a family trust set up by her grandmother in 1990 with an Isle of Man corporate trustee (the "**Settlement**"). By 2003, the gross value of the trust fund was approximately £3.6 million and comprised significant unrealised gains. The potential UK CGT liability if the gains were realised was over £1 million.

In 2002, the Isle of Man trustee took advice from PwC in London and decided to use a CGT tax scheme (commonly known as a "Round the World" scheme) to realise the retained gains in a tax efficient manner.

- "Round the World" schemes were designed to avoid the effect of certain UK legislative provisions which operated to attribute realised gains of a non-UK resident (or dual resident) settlement to a UK domiciled and resident settlor (in so far as that settlor had a (broadly defined) interest in the settlement) (the "**Settlement Provisions**").

- The scheme involved appointing non-UK resident trustees based in a country (1) which did not itself tax capital gains, but (2) which had taxing rights (to the exclusion of the UK) over any capital gains by virtue of the terms of a double tax treaty with the UK.

- The non-UK trustees realised the relevant gains without incurring a tax liability in the UK (or the jurisdiction in which they were resident). The non-UK trustees would then be replaced by UK resident trustees within the same year of assessment in order to exclude the operation of the Settlement Provisions (which applied only where the trustees remained non-UK resident throughout the relevant year of assessment) and related provisions.

In 2002, pursuant to PwC's advice, the Isle of Man trustee retired and was replaced by trustees resident in Mauritius (the "**Mauritian Trustees**"). In 2003, the Mauritian Trustees realised the Settlement's gains and distributed most of the trust fund to two new Isle of Man trusts. By a deed of retirement and appointment dated 19 March 2003 (the "**DORA**"), the Mauritian Trustees appointed the Claimant and the Defendant (both resident in the UK) as new trustees of the Settlement (the "**UK Trustees**"); the Mauritian Trustees retired; and the UK Trustees agreed to provide the Mauritian Trustees with an indemnity.

As regards the Claimant's participation in the DORA, the Claimant's evidence (in summary) was that her father had asked her to sign the document. More particularly, when she was asked to sign the document:

- she was not afforded any opportunity to read or consider it;
- she did not receive any legal advice in relation to it; though she appreciated that it "related to certain offshore trusts";
- she was under the impression that it related in some way to her (now deceased) mother's (then) ill health (and that she was to sign the document on her mother's behalf); and
- she was subject to considerable pressure from her father to sign it (and did not feel able to refuse him).

As to the pressure from her father (and what the Judge described might be termed "the overbearing nature of her father"), her evidence was that he had always been a forceful character and had "made the important decisions in the family and had dealt with the family's finances". Moreover, the Claimant's evidence was that, at the time she was asked to sign the DORA, she was in an extremely distressed, shocked and vulnerable state due to a family bereavement and her mother's ill health.

HMRC challenged the effectiveness of the scheme and assessed the UK Trustees to UK CGT on the gains realised by the Mauritian Trustees. The upshot of HMRC's contentions, described by the High Court variously as "somewhat surprising", "unconscionable", "unjust" and "extraordinary", was that the Claimant was liable for some £1.6million of UK CGT (her co-trustees now being virtually penniless) "despite having been appointed a trustee of a fund with only some £61,000 in cash in it at the time of her appointment". The Claimant appealed to the Tribunal against the assessments and, in parallel, applied to the High Court for an order rescinding her appointment as a trustee and/or a declaration that she never became a trustee.

In the High Court, the Claimant advanced her case on the basis of *non est factum*, lack of capacity, undue influence, and mistake.

DECISION

The High Court found against the Claimant on all four grounds.

At the heart of the adverse decision were findings that:

- the DORA was, in substance, a contract (rather than a unilateral transaction) whereby in consideration of the UK Trustees being appointed, they covenanted to indemnify the Mauritian Trustees (the "**Contract Finding**"); and

- even if the appointment of the Claimant as a trustee could be disaggregated from that contract and considered in isolation as a unilateral transaction, it was a transaction effected by the Mauritian Trustees and not the Claimant (the "**Appointment Finding**").

Non est factum

To succeed on a plea of *non est factum*, a party must establish (in essence) (1) a belief that the document they signed was radically different to the one they intended to sign, and (2) that this belief was induced by some form of misleading explanation or misrepresentation (rather than imprudence or negligence).

In the present case, the High Court found that the Claimant had not misapprehended the nature of the document she had signed: on her own evidence, she appreciated that the document related to certain offshore trusts. Further, although the Claimant did not realise that by accepting the appointment she risked accepting a large tax liability, that was irrelevant: the doctrine of *non est factum* is concerned with mistakes as to the nature (or "operative effect") of a document, not its consequences. (This is different to the position in relation to "unilateral mistake", as determined in *Pitt* v *Holt* [2013] UKSC 26.) Moreover, even if the Claimant had made a fundamental mistake, there was no evidence that she had been misled into that mistake.

Insofar as the Claimant advanced her case on the basis that she had lacked the capacity to appreciate that the document related to her appointment as a trustee, the High Court declined to accept her position in the absence of any medical evidence as to her capacity at the time (see further below).

Finally, the High Court held that even if the Claimant has been misled as to the true nature of the document she was signing, this would have been an irrelevance. This was on the basis of the Appointment Finding: specifically, because the appointment was an act done on the part of the Mauritian Trustees it could not be avoided on the basis of some vitiating factor on the part of the Claimant. In other words, it would have been necessary for the Mauritian Trustees to plead that *they* had been misled as to the true nature of the DORA (which, on the facts, clearly was not the case).

Lack of capacity

The High Court reiterated that whilst a unilateral transaction is *void* where it is entered into without capacity, a contract is *voidable* at the instance of the incapacitated party only where the other party knew (or ought to have known) of the incapacity.

In accordance with the Contract Finding, the High Court declined to hold that the appointment of the Claimant was void (even if incapacity could be established). As a result, in order to succeed in having the appointment set aside, the Claimant needed to adduce evidence that the Mauritian Trustees knew of the alleged incapacity. However, as the Court put it, there was no evidence before it "*that the Mauritian Trustees had any inkling of any suggestion of a lack of capacity in the Claimant*".

The High Court did go on to consider and apply sections 2 and 3 of Mental Capacity Act 2005 (which centre on the inability of a person to make a decision in relation to a particular matter due to an impairment of, or an disturbance in the functioning of, the mind or brain). Although the Court accepted the Claimant's evidence that, at the time she signed the DORA, she was "consumed by grief and truthfully incapable of making any decisions", it found that this evidence addressed with insufficient particularity the test in the Mental Capacity Act. Further, the Court made clear that it would be unwilling to find in favour of the Claimant in the absence of expert medical evidence (which, the Court reiterated, is necessary "*in all except very clear cases*" of mental incapacity).

Mistake

In a similar vein to the position in relation to lack of capacity, the Court confirmed that it is much easier to set aside a transaction (on grounds of mistake) where it is unilateral. Specifically (and as set out in *Pitt* v *Holt*) a voluntary disposition can be set aside whenever there is a causative mistake so grave that it would be unconscionable to refuse relief. Where rescission is sought of a contract, the common law regime is much narrower and requires (relevantly) evidence that there was a common mistake (shared by the parties) which (1) makes the contract impossible to perform or (2) makes the contract's subject matter "essentially and radically different form the subject matter which the parties believed to exist".

Again, in accordance with the Contract Finding, the Court declined to approach the Claimant's appointment as a unilateral transaction on the part of the Claimant. As to whether there had been any mistake on the part of the Mauritian Trustees, again, the Court found itself without the necessary evidence (albeit, on the facts, it seems unlikely that the Claimant would have been able to adduce evidence of a mistake on the part of the Mauritian Trustees even if she had turned her mind to it).

Moreover, in the Court's view, there had been no mistaken belief on the part of the Claimant (which could have formed the basis of a claim for unilateral mistake): rather, there had been "causative ignorance". In the Court's view, the tacit assumption by the Claimant that her father "would not ask her to sign documents which would put her in danger" was too wide and vague to constitute a relevant mistake as to the effect or consequence of signing the DORA. (Contrast this with an erroneous representation from the Claimant's father, or one of the professional advisers, that engendered a conscious and specific belief on the part of the Claimant that no adverse tax consequences would ensue.)

Undue influence

Citing the principle of “presumed” undue influence as set out by Lord Nicholls in *Royal Bank of Scotland Plc* v *Etridge (No.2)* [2001] UKHL 44, the High Court found that a prima facie case was made out. Namely, that the Claimant placed trust and confidence in her father, the Defendant, in relation to the management of her financial affairs; and that the transaction whereby the Claimant became a trustee “calls for an explanation”.

On that basis, had the transaction been a simple bilateral transaction between the Claimant and her father, the Court would have “no hesitation” in setting aside the transaction. However, in line with the Appointment Finding, the Court found that the transaction was one effected by the Mauritian Trustees and wholly untainted by undue influence.

COMMENT

The decision highlights that claimants (and their advisers) should take great care in formulating applications for equitable relief and ensuring that the necessary evidence, from the right parties, is before the Court. It also highlights the benefit, if possible, to identify and challenge a unilateral disposition rather than a multilateral transaction.

In the light of the High Court’s finding that the appointment of the Claimant was a unilateral act on the part of the Mauritian Trustees (untainted by mistake or undue influence), the Claimant applied (in her application for permission to appeal) to amend her application to seek, in the alternative, the setting aside of her acceptance of trusteeship and a declaration that she was at liberty to disclaim the trusteeship. Unfortunately for the Claimant, permission to amend, and permission to appeal, was refused by the High Court. In particular, having regard to the importance of finality in litigation and the overriding objective, permission to amend was refused on the basis that the amendments proposed were ineffective or insufficiently precise, and that (among other things) further evidence would need to be admitted at a very late stage of the claim.

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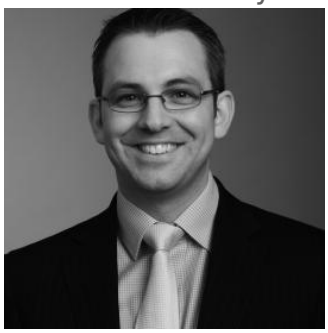

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