Bermuda's Statutory Hastings Bass - If I Could Turn Back Time…

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IMAGINE YOUR CLIENT IS A BENEFICIARY OF A TRUST which provides the trustee wide discretionary powers over trust distributions. Your client requests the trustee to make a large distribution to him or her after receiving tax advice that minimal tax will be payable on the distribution. The trustee receives confirmation of the tax advice and makes the distribution as requested. What could possible go wrong?

Unfortunately, after the distribution was made, your client discovers that the tax advice was incorrect and that he or she has actually incurred a significant tax liability. Had your client and the trustee known that the tax liability would have been incurred or was as significant as it was, the trustee never would have made the distribution.

Your client's lawyer writes to the tax adviser outlining your client's claim for damages but it is clear the tax adviser is not going to admit liability in a hurry, nor will his insurer allow it. Perhaps the best your client can hope for is to pay the tax liability and, after a long, expensive and stressful court case, recover from the tax adviser or perhaps the trustee damages representing some of the unanticipated tax.

Aside from engaging in hostile litigation with their advisers and trustees, there have been two main equitable remedies available for those seeking to set aside transactions where there have been unexpected adverse consequences:

- Firstly, the so-called rule in Re Hastings Bass, which had been the remedy most successfully relied upon by trustees and other fiduciaries in the United Kingdom (UK) and its Overseas Territories and Crown Dependencies until the UK Court of Appeal decision and, subsequently, the UK Supreme Court's decision in Pitt v Holt and Futter v Futter[1]; and
- Secondly, the doctrine of mistake which may be regarded as a more difficult basis upon which to set aside a decision, albeit unlike the Re Hastings Bass remedy, may be utlised by non-fiduciaries as well as fiduciaries.

The So Called Rule in Re Hastings Bass

The rule in Re Hastings Bass had been construed as providing the court the power to set aside, not just trustees' but other fiduciaries' exercise of discretions if:

- the effect of the exercise was different from that which the fiduciary had intended; and

1 Court of Appeal [2011] EWCA Civ 197; Supreme Court [2013] UKSC 26.

- it was clear the fiduciary would not have acted as it did had it not failed to take into account relevant considerations or had it not taken into account irrelevant considerations.

The rule in Re Hastings Bass had been used to great effect to in essence, rewrite history, to treat distributions and other exercise of powers by fiduciaries as though they had never occurred. As a result the beneficiary and the trustee could in effect amicably work together to bring an application to have the transaction set aside, avoid the additional unanticipated tax (assuming the decision would be recognised in the jurisdiction in which the tax liability was incurred) and therefore not have to consider expensive drawn out hostile court proceedings.

Pitt v Holt and Futter v Futter

However, the application of the rule in Re Hastings Bass was restricted considerably in both the UK Court of Appeal and Supreme Court decisions in Pitt v Holt and Futter v Futter. The Courts determined that the previous application of the Re Hastings Bass rule to set aside transactions where the fiduciary had not breached its duty were wrong in principle. In Pitt v Holt and Futter v Futter the fiduciaries relied on advice from apparently competent tax advisers. The advice turned out to be wrong. Both the UK Court of Appeal and the Supreme Court held the fiduciaries were not in breach of duty for relying on the advice. Accordingly, the remedy under the rule in Re Hastings Bass under its new (and most consider, correct) application was not granted.

Availability of the statutory Hastings Bass Remedy

Is the remedy of Re Hastings Bass as it was prior to Pitt and Holt and Futter and Futter available in, for example, the Bahamas, the BVI, Isle of Man, Guernsey, Cayman Islands and other Overseas Dependencies and Crown Dependencies other than Bermuda and Jersey? It now appears it may not be, if the case makes it way to the UK Privy Council or if those offshore jurisdictions follow Pitt v Holt and Futter v Futter which, it appears they may be bound to do without having the benefit of statutory provisions in place to in effect preserve the previous application of the rule.

Bermuda and Jersey

Fortunately, in Bermuda, the remedy in Re Hastings Bass as applied prior to Pitt v Holt and Futter v Futter has been preserved with the introduction of section 47A into Bermuda's Trustee Act 1975.

Jersey has also introduced statutory Hastings Bass provisions into its trust law, although some consider that the scope of Jersey's statutory Hastings Bass may not be as wide as that of Bermuda because Bermuda's version may also apply to non-trustee fiduciaries.

The Conditions

If the Bermuda Court decides to set aside a fiduciary's exercise of its power it can do so in whole or part, unconditionally or on such terms as the Court may think fit.

The conditions which need to be satisfied for the Court to exercise its jurisdiction under section 47A are that, firstly, the fiduciary:

- did not take into account one or more considerations that were relevant; or
- took into account one or more considerations that were irrelevant to the exercise of the power;.

Secondly, but for the failure to take into account such relevant considerations, or having taken into account such irrelevant considerations, the fiduciary:

- would not have exercised the power; or
- would have exercised the power, but on a different occasion or in a different manner to that in which it was exercised.

Section 47A(8) of the Trustee Act 1975 defines fiduciary power broadly, thus enabling a Court to set aside not just discretionary distributions to beneficiaries but also (i) borrowing or procuring dividends from an underlying company; and (ii) exercise of fiduciaries' administrative discretions in their dealing with third parties[2]. The latter may not have been possible under an application of Re Hastings Bass, even prior to Pitt v Holt and Futter v Futter. Section 47A(2) clarifies that in order for the Court to set aside a fiduciary's power, the fiduciary would not (as opposed to might not) have exercised the discretion at all, in the particular way or at the particular time. Importantly, the conditions may be satisfied without it being alleged or proved that in exercise of the power, the fiduciary, or any adviser to such fiduciary, acted in breach of trust or duty.

Date of Application

Section 47A has retroactive application and, further to the extent the exercise of power is set aside, the exercise of power shall be treated as never having occurred. This is in contrast to the Supreme Court's decision in Pitt and Futter which held that the transaction would be voidable rather than void. Persons with the power to change the governing law of existing trusts may wish to explore changing the governing law of the trust to Bermuda with the view of bringing an application in Bermuda to set aside an exercise of a fiduciary's discretion notwithstanding the discretion was exercised prior to the introduction of section 47A.

Limits

There are limits to the Court's ability to set aside transactions under section 47A, many which mirror those under the old application of the Re Hastings Bass rule.

Firstly, section 47A(6) provides that the Court cannot make an order to set aside a transaction which would prejudice a bona fide purchaser for value of any property without notice of the facts which would allow the Court to set aside an exercise of power. This does not prevent the Court making an order to grant the relief under section 47A if such a purchaser consents to the application.

Secondly, a fiduciary that exercises a power being aware of all the risks of the relevant transaction would be unlikely to satisfy the conditions.

Thirdly, the limitation of the application of section 47A to fiduciary powers that the trustee would not have exercised (as detailed above) may impact on the ability of courts to set aside the exercise of fiduciary powers by, for example, pension trustees who might not have refused a member's entitlement to early retirement on the basis of ill health had the trustees been more fully appraised of the member's condition.[3]

Fourthly, the remedy is a discretionary remedy and the Court is not compelled to exercise its discretion to set aside a transaction in full or in the manner which the fiduciary or the beneficiary

2 See presentation by Hon Mr Justice David Hayton of the Caribbean Court of Justice, Latest Developments in the Offshore World paper presentation at the Transcontinental Trusts: Bermuda Forum, 27 April 2015 at the Fairmont Southampton, Bermuda.

3 See note 2.

considers desirable. However, it is considered the Court will generally be sympathetic to the application for an order under section 47A where there is no prejudice to third parties.

Finally, section 47A applies to exercise of fiduciary powers. The Court does not have power to set aside exercise of a non-fiduciary power under section 47A. For example, Section 47A could not generally be deployed to set aside the settlor's exercise of a power to revoke a trust or transfer assets into a trust.

There may be other remedies such as rescission under the equitable doctrine of mistake which may enable the exercise of non-fiduciary powers to be set aside. Jersey has amended its trusts law, with the view of providing clarity to the application of the principles of mistake in Jersey.

Following the Supreme Court's decision in Pitt v Holt, Futter v Futter, the ability to set aside a gratuitous disposition based on mistake may be problematic in cases which reach the Privy Council in the UK where the unanticipated consequences are UK tax liabilities. The Court suggested it may be reluctant to set aside decisions where the adverse consequences are as a result of misguided tax planning as such planning may be regarded as a social *evil*. In addition, it appears less likely that a UK Court will consider mistakes regarding the tax consequences, as opposed to a mistake regarding the basic legal effect of the transaction itself, as sufficiently serious to justify the Court's exercise of its discretion.

Interestingly, on the social *evil* point, the Guernsey Court in Nourse –v- Heritage Corporate Trustees Limited delivered a judgment in January 2015 which determined that legal tax planning as opposed to illegal tax evasion was not a social *evil* and that the settlor, who was labouring under a mistake regarding the tax consequences of a transaction involving legal tax planning, could have a transfer into a trust set aside. It is suggested that the courts of Bermuda and a number of other offshore jurisdictions may adopt a similar approach.

Where Does It Fit In?

Section 47A sits alongside section 47 in the Trustee Act 1975 and forms part of Bermuda's flexible regime for restructuring of trusts. Section 47 provides the court wide powers to authorise transactions provided the transactions are in the interests of the beneficiaries as a whole. Section 47 has been applied to vary beneficial interests in trusts. Significantly, an application does not require the consent of all adult beneficiaries.

Section 47A may become relevant in the context of Bermuda's reserved powers legislation in circumstances where reserved powers have been designated as fiduciary powers and have been exercised in a flawed manner. Section 2A was introduced into the Trusts (Special Provisions) Act 1989 last year, providing a wide list of powers that could be reserved to the settlor or granted to another person without invalidating the trust. Section 2A provides that such powers may be categorised in the trust instrument as fiduciary or non-fiduciary.

Bermuda's version of statutory Hastings Bass is an important addition to Bermuda's already very attractive regime for restructuring trusts and offers a flexible remedy to resolve potential disastrous unanticipated consequences of decisions.