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The effect of 'social evils' on trustees' decisions

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Abstract

Should trustees be concerned about the increasing public condemnation of tax avoidance as a social disgrace? Are there any other moral pitfalls of which trustees should be aware in managing trust property? What has been the reaction in other jurisdictions to the growing criticisms of artificial tax avoidance?

In *Pitt v HMRC and Futter v HMRC*[1] Lord Walker made the following comments (at para 135):

> In *Futter* this court declined to permit the appellants to raise for the first time the issue of mistake, primarily because there was no sufficient evidential basis for considering that issue for the first time on a second appeal .... Had mistake been raised in *Futter* there would have been an issue of some importance as to whether the Court should assist in extricating claimants from a tax avoidance scheme which had gone wrong. The scheme adopted by Mr Futter was by no means at the extreme of artificiality (compare for instance, that in Abacus Trust Co (Isle of Man) v NSPCC [2001] STC 1344) but it was hardly an exercise in good citizenship. In some cases of artificial tax avoidance the court might think it right to refuse relief, either on the ground that such claimants, acting on supposedly expert advice, must be taken to have accepted the risk that the scheme would prove ineffective, or on the ground that discretionary relief should be refused on the grounds of public policy. Since the seminal decision of the House of Lords in WT Ramsay Ltd v IRC there has been an increasingly strong and general recognition that artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures. But it is unnecessary to consider that further on these appeals.

This article examines the following questions arising out of those comments:

i. Is there an increasingly strong and general recognition by the Courts that artificial tax avoidance is a social evil?
ii. If the Court wishes to prevent the social evil of artificial tax avoidance schemes in the context of equitable remedies, what is the legal basis for doing so?
iii. Are there any other emerging social evils that are likely to concern the Courts where trusts are concerned?
iv. How should trustees respond to these judicial trends on moral issues?

Is there an increasingly strong and general recognition by the Courts that artificial tax avoidance is a social evil?

There has been a great deal of press coverage of the actions of companies such as Amazon, Starbucks and Google in avoiding corporate taxes, and in the summer of 2012 the comedian Jimmy Carr felt

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1. [2013] UKSC 26.

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obliged to issue a public apology for his '*terrible error of judgment*' in using a tax avoidance scheme that was perfectly legal. At the time, David Cameron commented that some tax avoidances schemes were '*quite frankly morally wrong*'; and in 2013 HMRC updated its detailed guidance on the fit and proper persons test for charity trustees to advise that an individual who had '*been involved in designing and/or promoting tax avoidance schemes*' might not be a fit and proper person to manage a charity. So there is clearly a perception in some quarters that tax avoidance is unacceptable: but do the Courts share that view?

The case of *WT Ramsay Ltd v IRC*[2] marked a sea-change in the interpretation of tax statutes by moving away from a literal and formalistic approach to statutory interpretation towards a more purposive approach designed to identify the true nature of a transaction when applying tax statutes. In *Barclays Mercantile Business Finance Ltd v Mawson*[3] there is a useful passage in the judgment of the House of Lords (at paras 26–38) explaining the background to the decision in *Ramsay* but also highlighting the parameters of the so-called *Ramsay* 'principle' as being confined to statutory construction. In particular, paragraphs 37 and 38 of the judgment the House of Lords referred to the case of *MacNiven v Westmoreland Investments Ltd*[4] as showing

> the need to avoid sweeping generalisations about disregarding transactions undertaken for the purpose of tax avoidance

and

> the need to focus carefully upon the particular statutory provision and to identify its requirements before one can decide whether circular payments or elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of the statute.

The so-called *Ramsay* 'principle' is therefore *not* a principle that allows the Court as a general rule to disregard transactions in tax avoidance schemes or to refuse to allow such schemes to have efficacy as a matter of discretion, but is rather a principle that has been adopted to give tax statutes efficacy. Indeed, in the recent case of *McLaughlin v IRC*[5] the First-Tier Tribunal (at paragraph 134) set out, with approval, Lewison J's review of the *Ramsay* principle in *Berry v Revenue and Customs Commissioners*[6] which included the comment that '. . . *tax avoidance schemes sometimes work*'.

Other recent cases suggest that tax avoidance, in general, does not appear to be regarded by the Courts as a social evil that ought to be thwarted by the Courts.

In the context of an application for rectification of a deed, the Court in *Ashcroft v Ashcroft*[7] reaffirmed well-established practice of the Court to permit rectification of a document even where the purpose for which the document was created was to gain a tax advantage. In his judgment His Honour Judge QC said (at para 17):

> In the present case, the claim to rectification was formulated in response to a claim by HMRC for additional inheritance tax. In my judgment, the effect of the authorities is that the court cannot rectify a document *merely* because it fails to achieve the fiscal objectives of the parties to it. A mere misapprehension as to the tax consequences of executing a particular document will not justify an order for its rectification. The specific intention of the parties as to how the fiscal objective was to be achieved must be shown if the court is to order rectification. The court will order the rectification of a document only if it is satisfied by

2. [1982] AC 300.
3. [2004] UKHL 51.
4. [2003] 1 AC 311.
5. [2012] UKFTT 174.
6. [2011] UKUT 81 (TCC).
7. [2010] EWHC 1948 (Ch).

> cogent evidence (sufficient to counteract the effect of the parties' subscription to the relevant document) that: (1) the document does not give effect to the true agreement or arrangement between the parties, and (2) there is an issue, capable of being contested, between the parties; it being irrelevant, first, that rectification of the document is sought or consented to by all of them; and secondly, that rectification is desired because it has beneficial fiscal consequences.

In that case, rectification of a deed of variation enabled the parties to it to reduce the burden of inheritance tax chargeable on a deceased's estate.

In the context of the considering the circumstances in which the Court can '*pierce the corporate veil*' the Supreme Court in *Prest v Petrodel Resources Ltd*[8] commented as follows (at para 36):

> In the present case, Moylan J held that he could not pierce the corporate veil under the general law without some relevant impropriety, and declined to find that there was any. In my view he was right about this. The husband has acted improperly in many ways. In the first place, he has misapplied the assets of his companies for his own benefit, but in doing that he was neither concealing nor evading any legal obligation owed to his wife. Nor, more generally, was he concealing or evading the law relating to the distribution of assets of a marriage on its dissolution. It cannot follow that the court should disregard the legal personality of the companies with the same insouciance as he did. Secondly the husband has made use of the opacity of the Petrodel's Group corporate structure to deny being its owner. But that, as the judge pointed out, at para 219, 'is simply the husband giving false evidence.' It may engage what I have called the concealment principle, but that simply means that the court must ascertain the truth that he has concealed, as it has done. The problem in the present case is that the legal interest in the properties is vested in the companies and not in the husband. They were vested in the companies long before the marriage broke up. Whatever the husband's reasons for organising things in that way, there is no evidence that he was seeking to avoid any obligation which is relevant in these proceedings. The judge found that his purpose was 'wealth protection and the avoidance of tax: para 218. It follows that the piercing of the corporate veil cannot be justified in this case by reference to any general principle of law.

So tax avoidance alone does not involve such impropriety (or social evil) as to justify piercing a corporate veil.

In the professional negligence context, in *Hossein Mehjoo v Harben Barker*[9] an accountancy firm was found to be liable in negligence for failing to advise a client that he had non-domiciled status which meant that a particular tax avoidance scheme—Bearer Warrant Planning—was available to him. However, the judge commented (at para 359) that the particular scheme that was available was '*based on clear statutory provisions and has no artificial or contrived feature about it*', and he referred to the 11 January 2001 edition of *Taxation Magazine* where Bearer Warrant Planning was described as a '*simple and effective device to avoid capital gains tax*'. In reversing the decision on the accountants' negligence the Court of Appeal made no comment on the morality of the Bearer Warrant Planning scheme.

In the variation of trusts context, the Court has always been willing to sanction a variation of trusts with beneficial tax consequences, and if any judicial authority is needed for that practice, it can be found in the comments of Norris J in *Wyndham v Egremont*,[10] when he said (at para 25):

> Just as the court may be willing to approve an arrangement varying the trusts of a settlement with a view to mitigating potential tax burdens, it is unlikely to be unwilling to approve an arrangement which has adverse tax consequences for those on whose behalf

8. [2013] UKSC 34.
9. [2013] EWHC 1500 (QB).
10. [2009] EWHC 2076 (Ch).

> it is concerned to give its approval unless those consequences are more than outweighed by other benefits.

So tax avoidance, in general, does not appear to be viewed by the Courts as a social evil. Perhaps the difference is that 'artificial' tax avoidance schemes are increasingly to be regarded as a social evil, but tax avoidance which is not 'artificial' is permissible.

In *William Blumenthal v HMRC*[11] the First-Tier Tribunal decided as a matter of construction of the relevant statutory provisions, following the *Ramsay* approach, that various deeds of variation of loan notes were not effective to reduce the value of the loan notes for the purposes of capital gains tax. HMRC also argued that the deeds of variation could not operate to depress the value of the loan notes because of a drafting error in the deeds. The Tribunal agreed and found that the words in the deeds were unambiguous so that the defect in the drafting could only be remedied, if at all, by rectification. The Tribunal also commented (at para 136), although it was not necessary for their decision, that in many of the authorities on contractual interpretation, reference was made to favouring an interpretation which makes '*business*' or '*commercial common sense*', but that none of those authorities involved tax avoidance schemes, and went on to say (at para 139):

> It is, therefore, somewhat strained to speak of commercial common sense or business purposes in the context of such artificial tax-driven arrangements. Had the words used by the Appellant and O2 been ambiguous we would nonetheless have sought to interpret the Deeds of Variation in accordance with the intention of the parties, determined objectively. We would, however, be wary, particularly in a case where unambiguous language is used, of re-writing a contract under the supposed guise of contractual construction to give effect to an uncommercial and artificial tax-driven purpose. Had it been necessary for our decision, we would have refused to do so.

It would be odd in the context of the construction of settlements and other trust documents to talk in terms of a '*business*' or '*commercial*' purpose to a document given that dispositive documents in relation to a trust context—even in the context of a tax avoidance scheme—can have no '*commercial*' or '*business*' purpose. However, the quoted passage from the Tribunal in the *William Blumenthal v HMRC* case shows a judicial reluctance to assist an applicant in construing a contract made in the context of an artificial tax avoidance scheme, and that reluctance could extend to applications made by trustees for assistance in construing trust documents executed in the context of an artificial tax avoidance scheme where something has gone wrong with the language of the documents.

If the Court wishes to prevent the social evil of artificial tax avoidance schemes in the context of equitable remedies, what is the legal basis for doing so?

Lord Walker in *Futter* clearly thought that it was open to the Court to refuse equitable relief in the context of a tax avoidance scheme on the basis either that (i) the claimants, acting on expert advice, had taken the risk that the tax avoidance scheme would not work, or that (ii) discretionary relief should be refused on the grounds of public policy.

The suggestion that the Court might refuse to grant an equitable remedy where to do so would facilitate a tax avoidance scheme—even an artificial one—is somewhat radical.

The classic case which is often relied upon to demonstrate the Court's willingness to permit a taxpayer to arrange his affairs so as to minimize his tax bill is

11. [2012] UKFTT 497 (TC).

Commissioners of Inland Revenue v Duke of Westminster,[12] where Lord Tomlin said (at p 19):

> Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

That comment was made in the context of deciding whether or not the Commissioners could go behind the form of the documents and look at the substance of what had been done. In brief, the Duke of Westminster had covenanted to pay his gardener a yearly sum by weekly payments for the period of seven years or their joint lives, and had agreed that the payments were without prejudice to any remuneration that the gardener might subsequently be paid for his services. The Commissioners argued that the weekly payments were salary, but the House of Lords held that they were not, and that the Duke of Westminster was entitled to deduct the payments in calculating his total income for the purposes of surtax. The case is an example of the Court applying taxation statutes literally rather than looking at the substance of a transaction, but it does not offer any support for an argument that the Court cannot, or should not, refuse to grant relief on the grounds of a public policy of the deterrence of tax avoidance because the case did not involve any application for equitable relief. The question was simply one of statutory construction, where the Court decided that the taxpayer has succeeded in arranging his affairs to minimize his tax liability, but Lord Tomlin's comment provides no basis for an argument that the Court will also invariably assist a taxpayer in minimizing his tax if he has *failed* to do so himself.

There are, of course, many instances of the Courts refusing to enforce a trust, or to grant equitable relief, on the grounds of public policy. However, in *Re Beard*[13] Swinfen Eady J warned that

> When questions arise as to conditions or provisions being void as being against the public good or against public policy, great caution is necessary in considering them; at different times very different views have been entertained as to what is injurious to the public.

In that case he found that a condition in a will divesting the interest of a legatee if he entered into the naval or military services of the country was void as against public policy, commenting that

> in my opinion, however, there can be few, if any, provisions more against the public good and the welfare of the State than one tending to deter persons from entering the naval or military services of the country.

In *Blathwayt v Baron Cawley*[14] the House of Lords held that a religious forfeiture clause in a will should not be struck down on the grounds of public policy, and Lord Simon of Galisdale commented (at p 427) that

> Courts are concerned with public policy only in so far as it has been manifested by parliamentary sanction or embodied in rules of law having binding judicial force.

There is now—since the embodiment of a general anti-abuse rule ('GAAR') in sections 206–215 of the Finance Act 2013—parliamentary sanction for the proposition that abusive tax avoidance is contrary to public policy. The GAAR gives the Court power to counteract tax arrangements that are abusive by making adjustments that are 'just and reasonable', including the imposition of, or increase in, a liability to tax in any case. Section 207(2) provides that tax arrangements are 'abusive' if they cannot 'reasonably'

12. [1936] AC 1.
13. [1908] 1 Ch 383.
14. [1976] AC 397.

be regarded as a 'reasonable' course of action in relation to the relevant tax provisions, and section 207(4) provides some examples of indicators of abusive tax arrangements including (a) significantly deflated income, profits or gains for tax purposes, (b) significantly augmented deductions or losses, and (c) the repayment or crediting of tax that has not been and is unlikely to be paid.

An important consequence the introduction of the GAAR is that there is now parliamentary sanction for a public policy against abusive tax arrangements.

It must also follow from the introduction of the GAAR, however, that if an artificial tax avoidance scheme does *not* fall foul of the GAAR then the Court should not be unwilling to assist claimants seeking an equitable remedy in relation to that tax avoidance scheme on the grounds of public policy. In other words, the extent of the Court's application of public policy principles in exercising any discretions to grant equitable relief should be limited to the scope of the GAAR.

This point is made very neatly by Malcolm Gammie in his article.[15] At p 582 Mr Gammie refers to statement in Paragraph B2.3 of the GAAR Guidance, which suggests that

> Taxation is not to be treated as a game where taxpayers can indulge in any ingenious scheme in order to eliminate or reduce that tax liability

and he comments that

> In fact it is, because the GAAR does not strike at 'ingenious schemes' at all but at 'abusive schemes': ingenious tax planning is fine; abusive schemes are not.

So perhaps this is the legal basis of Lord Walker's warning in *Futter* about the social evil of tax avoidance, and the important word in any application for equitable relief in the context of a failed tax avoidance scheme, and the consideration of whether such an application should be granted or refused, will not be 'artificial' but rather 'abusive'.

Are there any other emerging social evils that are likely to concern the Courts where trusts are concerned?

Another potential 'social evil' that seems to be developing in the public consciousness is the investment of funds in morally dubious enterprises. In the summer of 2013 the Most Reverend Justin Welby told the online lender Wonga that the Church would try to force the firm out of business by helping credit unions compete with it, although he later had to admit that he was 'embarrassed' and 'irritated' that the Church of England had invested in Wonga, albeit indirectly. Then, in December 2013 BBC Panorama reported that millions of pounds donated to Comic Relief had been invested in funds with shares in tobacco, alcohol, and arms firms and criticized the charity for investing in BAE Systems (weapons), Diageo (alcohol), and unspecified tobacco companies. Comic Relief defended its approach as being within regulatory guidelines and aimed at delivering the greatest benefits to the most vulnerable people. The Charity Commission said at the time

> If a charity says 'we need to invest for the maximum financial return' that is right. If they go on to say 'we therefor can't have an ethical investment policy', that's wrong.

It is well-established that trustees must not allow their own moral or political beliefs to influence their fiduciary duty to invest their trust property properly in the best interests of the beneficiaries. In *Cowan v Scargill*[16] Sir Robert Megarry V-C said (at p287–88):

> [Trustees] may be firmly opposed to any investment in South Africa or other countries, or they may object to any form of investment in companies concerned

15. 'Moral Taxation, Immoral Avoidance—What Role for the Law?' (2013) 4 British Tax Review 577–90.
16. [1985] Ch 270.

> with alcohol, tobacco, armaments or many other things. In the conduct of their own affairs, of course, they are free to abstain from making any such investments. Yet under a trust, if investments of this type would be more beneficial to the beneficiaries than other investments, the trustees must not refrain from making the investments by reason of the views that they hold.

He went on to say that if beneficiaries had very strict views on moral and social matters, condemning all forms of alcohol, tobacco, and popular entertainment, as well as armaments, then it *might* be for their benefit for the trust fund to be invested in other activities even though that would produce lower financial returns, but he emphasized that such cases were likely to be very rare.

Even in the case of charities, the general position is that the charity trustees' choice of investments should be made solely on the basis of well-established investment criteria and cases where the objects of a charity are such that a particular investment might conflict with those objects will be comparatively rare. Even then, charity trustees can accommodate the views of those who object to a particular investment on moral grounds only if to do so would not involve a risk of significant financial detriment to the charity (see *Harries v Church Commissioners for England*[17]).

There is no suggestion that the Courts have altered the approach to trustees' fiduciary duties in relation to investments, but if the media continues to question the morality of particular investments this could be another area where the Courts respond to changing public attitudes in dealing with questions arising in a trust context.

How should trustees respond to judicial trends on moral issues?

Trustees need to be aware that some judges have recently expressed an unwillingness to grant equitable remedies to assist trustees in applications relating to artificial tax avoidance schemes. If this unwillingness becomes widespread it could extend to a refusal to infer that trustees had a particular intention when construing a document, or to rectify a document where trustees have made a mistake, or to hold that a document was made by mistake, or to sanction a variation of trust. If trustees find themselves in the position of needing the assistance of the Court in the context of a tax avoidance scheme that has gone wrong they might try to emphasize that the tax avoidance scheme is not 'artificial' (although in *Futter* it was acknowledged by Lord Walker that the scheme in question was not at the extreme of artificiality), or, if it is, that the Court should be cautious about the circumstances in which it will refuse a remedy on the grounds of public policy as there can be different views on the question of the morality of tax avoidance and the only parliamentary sanction on tax avoidance is on 'abusive' avoidance schemes.

There is unlikely to be any practical benefit for trustees in seeking to obtain the sanction of the Court prior to implementing any tax avoidance scheme (so as to try to avoid the need for any future applications for equitable remedies after the implementation of the scheme if mistakes are made in that implementation). The Court is unlikely to sanction an aggressive tax avoidance scheme as being effective without hearing argument from HMRC, and most taxpayers would not want to precipitate a Court battle with HMRC about the efficacy of a particular tax avoidance scheme.

As for the questions of ethical investments, although the media has lately been publicizing the issue of the morality of particular investments, the law is clear on this issue and there have not, so far, been any recent judicial comments on trustees' duties in this area. That said, the position needs to be monitored, as it would be easy for the Courts to make a small shift in emphasis on trustees' duties in relation to the investment of trust funds based on what is for the 'benefit' of beneficiaries in knowing the types of

17. [1992] 1 WLR 1241 at 1247.

enterprises in which their trust monies are being invested.

Some observations from other jurisdictions

Other jurisdictions have reacted speedily and adopted a different approach to the question of trustees' mistakes. This is unsurprising as one significant reason lying behind many offshore trusts is the tax position of the beneficiaries or the settlor in their place of residence or domicile, which is almost invariably different from the offshore jurisdiction hosting the trust.

Jersey has incorporated the so-called *Hastings-Bass* rule into statute in *The Trusts (Amendment No 6) Jersey Law 2013* under which the Jersey Royal Court can relieve trustees from the consequences of a mistake if the mistake is of so serious a character as to render it just for the Court to do so. Although there is no mention of a mistake as to tax consequences in the legislation itself, the statute could be relied upon where a mistake has been made as to the tax consequences of trustees' actions, and there has been no suggestion by the Jersey Royal Court that such a mistake would not be relieved simply because it was made in the context of an 'artificial' tax avoidance scheme.

In the Cayman Islands in a tax summit in November 2013 Chief Justice Anthony Smellie examined the application of the *Hastings-Bass* rule and said:

> In summary then, one can, I think, safely venture that post Futter and Pitt, the courts of the Cayman Islands will not be unduly hamstrung in the relief to be granted from unintended and unforeseen tax consequences arising from erroneous decisions of trustees.. . . .
>
> Nor am I, as an 'offshore' judge, unduly alarmed about Lord Walker's admonitions to trustees and beneficiaries for the acceptance of risk that an artificial tax avoidance scheme might go wrong.
>
> . . . .
>
> The perspective of the bench from a jurisdiction like the Cayman Islands is that from a place where there has never been direct income, capital gains or inheritance tax. A jurisdiction which therefore has never had the need in any sense 'artificially' to structure its laws so as unfairly to arbitrage the tax laws of other jurisdictions. Accordingly, notions of the refusal of relief by the court, 'on grounds of public policy' from the 'general recognition that artificial tax avoidance is a social evil must be considered in their proper context'.

We can see no difficulty with the legislative approach of Jersey. However, the public policy approach being suggested by Smellie CJ may give rise to problems, and whether it is effective promises to spawn some interesting cases. First of all, territories with a Westminster Model constitution (Cayman is one) are—broadly speaking—subject to the strait-jacket of the Privy Council. In the absence of local legislation, individual jurisdictions are rarely allowed to go their own way in interpreting the common law or equity. There is a second point, namely the extent to which the Courts might move on from the introspective rule that the Courts will uphold their local revenue law but not the revenue laws of foreign states. Anti-money-laundering legislation and general anti-avoidance rules in tax legislation are now found in many jurisdictions, and the Courts may well have increasing regard to comity in this area. What matters most is the attitude of one jurisdiction to tax avoidance in a different jurisdiction with a close and real connection with the individuals or corporations in question. Thirdly, and potentially most importantly, there may be a question as to how far HMRC will accept that it is bound by what foreign courts decide.

Conclusion

Whilst the difference between tax avoidance and tax evasion is easy to understand, the difference between tax avoidance and 'artificial' tax avoidance is more difficult to pinpoint. If 'artificial' tax avoidance is to be regarded as contrary to public policy so as to prevent the grant of equitable remedies then it ought to be confined to 'abusive' tax avoidance on the basis that it is only such tax avoidance that has been outlawed by Parliament. Although 'artificial' tax avoidance might be morally repugnant to some people, if it does not fall foul of the *Ramsay* principle then it can work, and it is up to Parliament to prevent it with clear legislation rather than leaving it to judges to impose their own moral judgments on the issue.

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