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Jurisdiction to Review Trustee Discretion — Case Comment on two UK Appeals *Pitt v. Holt*, *Futter v. Futter*[1]

The lengthy judgment of Lord Justice Lloyd in the Court of Appeal's decision on these two appeals released March 11, 2011, contains the following tantalizing sentence:[2]

> For the reasons that I have given above, in my judgment the principle known as the rule in Re Hastings-Bass . . . is not a correct statement of the law.

In his concurring opinion Lord Justice Longmore said the Hastings-Bass rule was an example of the law "taking a seriously wrong turn".[3] The legal press called the decision a "U-Turn".

Lloyd L.J.'s words are all the more tantalizing not only because the courts of England and Wales have applied the rule in *Hastings-Bass (Re)*[4] consistently since it was handed down in 1975, but also because one of the most recent and authoritative applications of the rule was the decision of Lord Justice Lloyd himself, sitting as a High Court judge, in *Sieff v. Fox*[5] only six years earlier.

What follows is a description of the rule in *Hastings-Bass (Re)*, the Court of Appeal's ruling in *Pitt* and *Futter*, and a brief consideration of what impact, if any, this will have in Canada.

The rule in *Hastings-Bass (Re)*

The rule concerns the court's jurisdiction to review a trustee's valid exercise of discretion in circumstances in which there are unintended

1. [2011] 3 W.L.R. 19, [2011] EWCA Civ. 197, [2011] 2 All E.R. 450, appeal to UKSC granted August 1, 2011.
2. *Ibid.*, at para. 131.
3. *Ibid.*, at para. 227.
4. [1975] Ch 25.
5. [2005] EWHC 1312 (Ch), [2005] 1 W.L.R. 3811.

consequences. It has been described as a powerful weapon enabling trustees to attack their own decisions in the face of objections by revenue authorities.[6]

In its original incarnation the rule in *Hastings-Bass (Re)* was that the court should not interfere with a trustee's exercise of discretion in good faith, notwithstanding that it does not have the full effect which the trustee intended, unless:

1. what the trustee achieved is unauthorized by the power conferred upon him, or
2. it is clear that he would not have acted as he did:
   (a) had he not taken into account considerations which he should not have taken into account, or
   (b) had he not failed to take into account considerations which he ought to have taken into account.

Of course the rule has been developed and shaped over the years since its pronouncement. The original negative formulation was re-worded in a positive formulation in *Mettoy Pension Trustees Limited v. Evans.*[7] In that case the evidence was that the trustees were unaware of a point in the new rules governing the windup of pensions. The court recast the rule as follows:

> Where a trustee acts under a discretion given to him by the terms of the trust, the court will interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account.

In *Sieff* the court reviewed *Hastings-Bass (Re)* and its subsequent applications over the intervening 30 years and formulated the rule as follows:[8]

> Where trustees act under a discretion given to them by the terms of the trust, in circumstances in which they are free to decide whether or not to exercise that discretion, but the effect of the exercise is different from that which they intended, the court will interfere with their action if it is clear that they would not have acted as they did had they not failed to take into account considerations which they ought to have taken into account, or taken into account considerations which they ought not to have taken into account.

In 2010 the rule in *Hastings-Bass (Re)* was applied in *Futter v. Futter* and in *Pitt v. Holt*. In each case the discretionary actions of the trustees resulted in unintended tax consequences as a result of failure

6. *Futter v. Futter*, [2010] EWHC 449 (Ch), at para 1.
7. [1990] 1 W.L.R. 1587, at p. 1621.
8. *Supra*, footnote 5, at para. 119.

to take into account relevant factors. At first instance the courts set aside the actions. In each case the UK Revenue authorities appealed.

1. At First Instance

In *Pitt v. Holt*,[9] Derek Pitt was very badly injured in a road accident in 1990. A structured settlement was reached on Mr. Pitt's behalf under which a lump sum and monthly payments were made. On professional advice the funds were put into a trust for Mr. Pitt's benefit, and the monthly payments were assigned to the trustees to be held on the same trust.

Set up in this way, substantial inheritance tax was payable. (The Court of Appeal found, "It would have been easy to create the settlement in a way which did not have these tax consequences.") Mr. Pitt's trustees commenced negligence proceedings against the professional advisers, but these were stayed pending an application for a declaration that the settlement by which the trust was created, and the assignment of the payments, were void or voidable and should be set aside. The relief was sought on the basis of the rule in *Hastings-Bass (Re)*, or alternatively on the ground of mistake.

The court handed down its decision on January 18, 2010. It held the settlement and assignment were to be set aside on the rule in *Hastings-Bass (Re)*, but would have not come to the same conclusion on the ground of mistake.

In *Futter*, the trustees exercised powers of advancement under two discretionary trusts. In one the trustees exercised their power in such a way that Mr. Futter became absolutely entitled to the fund. In the other, the trustees exercised their power so as to advance a sum to each of three children immediately. In each case the point was to transfer assets out of the settlement in such a way as to avoid incurring a charge to capital gains tax. The plan was that through the use of exemptions and capital gain losses incurred by each beneficiary; set off was available so that there would be no capital gains tax payable. In fact the advice given to the trustees by its lawyers was incorrect. Allowable losses could not be set off against gains attributed to beneficiaries in these circumstances. The trustees brought proceedings against the recipient beneficiaries seeking a declaration that the advancements were void, or alternatively an order setting them aside. There was no alternative submission made on mistake.

On March 11, 2010 the court ruled the advancements were vitiated under the rule in *Hastings-Bass (Re)* and should be set aside.

The UK revenue authorities appealed both decisions.

9. [2010] EWHC 45 (Ch).

2. At The Court of Appeal

The two appeals were heard together by the Court of Appeal on March 9, 2011.

Lord Justice Lloyd reviewed the rule in *Hastings-Bass (Re)*, its history and application in great detail, and concluded it was incorrect in law. The essential correction was this. Where the trustees acted within their powers, but their action was voidable due to breach of trust because the trustees failed to have regard to a relevant matter as required by their fiduciary duty, the court could intervene. However, if the reason that the trustees did not have regard to the relevant matter was that they had obtained and acted on advice from apparently competent advisors, which turned out to be incorrect, then the charge of breach of trust could not be made out. Unless breach of trust could be made out, the rule in *Hastings-Bass (Re)* was not available to vitiate the trustees' action.

Upon analysis of the facts in *Futter* and *Pitt* the Court of Appeal could not accept that the trustees' actions were in breach of their fiduciary duties, because in both cases the trustees took advice from competent legal advisors before acting. In *Pitt* the court stated that although the trustee Mrs. Pitt was entitled to feel badly let down by the advice she had received, the remedy "lies not in the realms of equity but by way of a claim for damages for professional negligence".

Both appeals by the Revenue authorities were allowed.

3. Equitable Relief for Mistake

The Court of Appeal also reviewed the equitable jurisdiction to set aside a voluntary transaction for mistake, because this relief was sought as an alternative in *Pitt*. The court reviewed the authorities and concluded that the correct test for the equitable jurisdiction to set aside a voluntary disposition for mistake contained three conditions: (a) a mistake; (b) the mistake must be of sufficient gravity; and (c) the mistake must be of the right type — it must be about the legal effects, not consequences. The court held that, in principle, the treatment for tax purposes of a transaction is a consequence, not an effect.

The court applied this test to the facts in *Pitt*. It held that even though on the evidence no one had turned their mind to how inheritance tax might affect the transaction, because the lawyers had advised there would be no adverse tax implications, there was a general belief which was false in one material respect. This satisfied the need for a mistake. It also held that the mistake was sufficiently

serious because the tax liability resulting from the disposition converted what was an adequate sum for Mr. Pitt's support into a sum significantly less than adequate for that purpose.

However the Court of Appeal did not accept that the mistake was of the right type. The legal *effect* of the disposition was the creation of the trust. The *consequence* was a tax liability imposed on Mr. Pitt, which became a charge on the trust property. The court's equitable jurisdiction to intervene on the ground of mistake was therefore not available.

4. Application to Canadian jurisprudence

Canadian courts have followed *Hastings-Bass (Re)*.[10] Whereas the UK cases referred to above were applications brought by trustees attacking their own decisions because of unfavourable tax consequences, in all the Canadian cases *Hastings-Bass (Re)* was cited in the context of challenges by others to the trustees' authority. *Hastings-Bass (Re)* was relied on as authority for the proposition that non-interference by the court is the general rule, except where a trustee acts on extraneous considerations. No Canadian case has applied *Hastings-Bass (Re)* to vitiate discretionary actions by a trustee for failure to take into account considerations that ought to have been taken into account.

In Canada applications to redo (or undo) decisions that have resulted in unforeseen tax consequences, are brought as rectification or rescission applications. The Ontario Court of Appeal's decision in

10. *Fox v. Fox Estate* (1996), 28 O.R. (3d) 496, 10 E.T.R. (2d) 229, 88 O.A.C. 201 (C.A.), leave to appeal to S.C.C. refused 97 O.A.C. 320*n*, 207 N.R. 80*n*; *Sutherland v. Hudson's Bay Co.* (2009), 51 E.T.R. (3d) 223, 77 C.C.P.B. 133, 82 C.P.C. (6th) 339 (Ont. S.C.J.); *Pacific Destination Properties Inc. v. Granville West Capital Corp.* (2009), 51 E.T.R. (3d) 206, 62 B.L.R. (4th) 303, 179 A.C.W.S. (3d) 729 (S.C.); *Neville v. Wynne* (2005), 16 E.T.R. (3d) 307, 46 C.C.P.B. 80 *sub nom. Neville v. Plumbing & Pipefitting Workers Local 170 Pension Plan (Trustees of)*, [2005] B.C.J. No. 712 (S.C.), affd 27 E.T.R. (3d) 1, 381 W.A.C. 121, 57 B.C.L.R. (4th) 199 (C.A.); *Yates v. Air Canada* (2004), 5 E.T.R. (3d) 281, 40 C.C.P.B. 121, [2004] B.C.J. No. 43 (S.C.); *Merry Estate v. Merry Estate* (2002), 62 O.R. (3d) 427 *sub nom. Meredith v. Plaxton*, 48 E.T.R. (2d) 72, 118 A.C.W.S. (3d) 478 (S.C.J.); *Edell v. Sitzer* (2001), 55 O.R. (3d) 198, 40 E.T.R. (2d) 10, 106 A.C.W.S. (3d) 1136 (S.C.J.), affd 9 E.T.R. (3d) 1, 187 O.A.C. 189, 131 A.C.W.S. (3d) 563 (C.A.), leave to appeal to S.C.C. refused [2005] 1 S.C.R. ix, 204 O.A.C. 400*n*, 336 N.R. 199*n*; *Hedley Estate v. Grant* (1998), 84 A.C.W.S. (3d) 818, 74 O.T.C. 234 (Ont. Ct. (Gen. Div.)); *Hunter Estate v. Holton* (1992), 7 O.R. (3d) 372, 46 E.T.R. 178, 32 A.C.W.S. (3d) 335 (Gen. Div.) and *Ryan Estate v. Boulos-Ryan* (2007), 266 Nfld. & P.E.I.R. 1, 2007 NLTD 40, 155 A.C.W.S. (3d) 614 (Nfld. & Lab. S.C.T.D.).

Juliar v. Canada (Attorney General)[11] is a good illustration of rectification. *Juliar* concerned a transfer of shares between family members of the family convenience store business essentially in order to divide the business so that new holding companies could be operated independently. The shares had been subject to an earlier transfer and the applicants' accountant believed, incorrectly, on the basis of information given to him that taxes had been paid upon that transfer. As a result a s. 85 rollover was not available, giving rise to an immediate tax liability. The applications judge rectified the transaction on the ground that there was a common and continuing intention from the outset to do the transfer on the basis which would not attract immediate tax liability. To do otherwise would yield Revenue Canada's premature gain because of an error in understanding or communication. The Ontario Court of Appeal agreed. *Juliar* has been followed numerous times in Canadian jurisprudence in a variety of situations — *Aylwards (1975) Ltd. Amalgamation (Re)*[12] (rectification of date and time of amalgamation); *Di Battista v. 874687 Ontario Inc.*[13] (error in estate freeze transaction); *Snow White Productions Inc. v. PMP Entertainment, Inc.*[14] (error in productions services agreement resulting in loss of tax credits); *GT Group Telecom Inc. (Re)*[15] (improper execution of merger resulting in loss of tax credits); *Razzaq Holdings Ltd. (Re)*[16] (error in reorganization of share capital); *Poscor Mill Services Corp. v. 2068159 Ontario Inc.*[17] (insufficient shares issued in exchange for predecessor corporation shares resulting in adverse and unintended tax consequences). In the Alberta decision *Stone's Jewellery Ltd. v. Arora*,[18] in which title to real estate was mistakenly taken in such a way as to trigger a $3 million immediate tax liability, the remedy of rescission was awarded instead of rectification.

Although these Canadian cases were not applications by trustees,

11. (2000), 50 O.R. (3d) 728, 136 O.A.C. 301, 8 B.L.R. (3d) 167 (C.A.), leave to appeal to S.C.C. refused 153 O.A.C. 195*n*, 272 N.R. 196*n*.
12. (2001), 203 Nfld. & P.E.I.R. 181, 16 B.L.R. (3d) 34 *sub nom. Amalgamation of Aylwards (1975) Ltd. (Re)*, 107 A.C.W.S. (3d) 46 (Nfld. S.C.).
13. (2005), 80 O.R. (3d) 136, [2006] 5 C.T.C. 152, 146 A.C.W.S. (3d) 467 (S.C.J.).
14. (2004), 46 B.L.R. (3d) 283, [2004] 3 C.T.C. 282, 2005 D.T.C. 5150 (S.C.).
15. (2004), 5 C.B.R. (5th) 230, 134 A.C.W.S. (3d) 540 (Ont. S.C.J. (Comm. List)).
16. (2000), 11 B.L.R. (2d) 157, 101 A.C.W.S. (3d) 924, 2000 BCSC 1829.
17. (unreported, December 21, 2007, Court File No. Toronto 07-CL-7306).
18. (2009), 314 D.L.R. (4th) 166, [2010] 5 W.W.R. 297, 20 Alta. L.R. (5th) 50 (Q.B.).

the same procedure can be used by trustees in Canada — *Wood Estate*.[19]

The situations described in these cases are indistinguishable from *Sieff*, *Futter* and *Pitt* in that they all involve deliberate, documented transactions that contain an error resulting in financial repercussions, which are contrary to the specific and continuing intentions of the parties from the outset of the transaction.

5. Conclusion

As we do not depend on the rule in *Hastings-Bass (Re)* in Canada to set aside trustee actions which have failed to take relevant factors into consideration, but approach the problem via rectification or rescission, the "U-turn" in *Pitt* and *Futter*, assuming it is upheld on appeal, is unlikely to have much impact for practitioners here.

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19. (unreported, July 15, 2003, Court File No. Toronto 02-CL-4724).

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