What is the rule in Hastings-Bass? The impact of *Pitt v Holt* and *Futter v Futter*

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On 9th March the Court of Appeal allowed the Revenue's appeals ([2011] EWCA Civ 197) against decisions which had allowed the trustees of a settlement in the *Futter* case ([2010] STC 982), and a Court of Protection receiver in the Pitt case ([2010] 1 WLR 1199), to extricate themselves from the adverse tax consequences of transactions entered into by them based on inappropriate advice.

Facts

In *Pitt v Holt*, Mrs Pitt sought to unravel a settlement and an assignment made by her as a Court of Protection receiver for her late husband who had been seriously brain damaged in a road accident. It had been decided to put the damages to which he became entitled under a compromise of a negligence claim into a discretionary settlement. The form of settlement adopted meant that Inheritance Tax (IHT) became payable on the creation of the settlement, on subsequent capital distributions, after 10 years and also on Mr Pitt's death. About £200-300,000 in IHT was at stake. The IHT position was not taken into account at all by Mrs Pitt and her advisers when the settlement was set up. If the settlement could be set aside there would be a large tax saving. In *Futter v Futter*, the trustees brought a settlement to an end in the hope of achieving a beneficial overall CGT position. The beneficiaries had CGT losses and it was hoped to be able to avoid a tax charge on trust gains. Tax advice had been taken but it was incorrect and there was a CGT bill which, it had been hoped, would be avoided.

In re Hastings-Bass Deceased [1975] Ch 25 (CA) was applied in both cases. The Courts set aside the transactions in reliânce on the judgment of Lloyd LJ in *Sieff v Fox* [2005] 1 WLR 381, which considered the *Hastings - Bass* case and subsequent authorities and formulated the principle under consideration as follows: *"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 take into account..."*

The significance of the Pitt and Futter cases

Lloyd LJ, giving the lead judgment, decided that his earlier first instance decision in *Sieff v Fox* was incorrect and that the *ratio decidendi* of *Hastings-Bass* was not as set out above, but as follows:

> *"64. Trustees considering an advancement by way of sub-settlement must apply their minds to the question whether the sub-settlement as a whole will operate for the benefit of the person to be advanced. If one or more aspects of the provisions intended to be created cannot take effect, it does not follow that those which can take effect should not be regarded as having been brought into being by an exercise of the discretion. That fact, and the misapprehension on the part of the trustees as to the effect that it would have, is not by itself fatal to the effectiveness of the advancement. ...If the provisions that can and would take effect cannot reasonably be regarded as being for the benefit of the person to be advanced, then the exercise fails as not being within the scope of the power of advancement. Otherwise it takes effect to the extent that it can."*

continued

Lloyd LJ drew a distinction between: (a) cases where the trustees' act was said to be void because it is was not authorised by the power under which they purported to act; and (b) acts within the powers of the trustees but which were said to be vitiated by the failure of the trustees to take into account a relevant factor to which they should have had regard - usually tax consequences - or by their taking into account some irrelevant matter. It seemed to him that the principled and correct approach to cases in category (b) was that the trustees' act was not void, but that it might be voidable, if, and only if, it could be shown to have been done in breach of fiduciary duty on the part of the trustees. If it was voidable, then it was capable of being set aside at the suit of a beneficiary, but this would be subject to equitable defences and to the court's discretion.

He thought that fiscal considerations would often be among the relevant matters which ought to be taken into account. However, if the trustees sought advice (in general or in specific terms) from apparently competent advisers as to the implications of the course they are considering taking, and followed the advice so obtained, then, in the absence of any other basis for a challenge, the trustees would not be in breach of their fiduciary duty for failure to have regard to relevant matters if the failure occurred because it turned out that the advice given to them was materially wrong. The result was that the Revenue won.

Mistake

Pitt v Holt also concerned the equitable jurisdiction to relieve against mistake. It was argued in the alternative that the receiver had entered into the transaction in question on the mistaken understanding that there would be no adverse tax effects, so that it should be set aside. The receiver lost on this point both at first instance and again on appeal.

In the context of a voluntary disposition such as a gift or transfer into settlement, reliance was placed on the decision of Lindley LJ in *Ogilvie v Littleboy* [1897] 13 TLR 399 at 400 (CA, affirmed in the HL), where to succeed one had to establish "*...some mistake of so serious a character as to render it unjust on the part of the donee to retain the property given to him*". It was submitted that there was a tension between such a broad approach and the narrower approach as expressed by Millett J in *Gibbon v Mitchell* [1990] 1 WLR 1304 at 1309: "*[A voluntary transaction] will be set aside for mistake whether the mistake is a mistake of law or of fact, so long as the mistake is as to the effect of the transaction itself and not merely as to its consequences or the advantages to be gained by entering into it.*"

The distinction between "effect" on the one hand and "consequences" on the other hand is difficult to apply. It had arisen before *Pitt* in several cases, eg. *Anker-Peterson v Christensen* [2002] WTLR 313,330. Unfortunate tax bills were thought to fall into the "consequences" category. Robert Engelhart QC held at first instance in *Pitt* the case was not really a case of mistake because, "*It is not as if Mrs Pitt ever wrongly thought, for whatever reason, that inheritance tax would not be payable. She simply never thought about it at all.*" Alternatively, he held that if he was wrong about that, any mistake was, adopting the terminology of Millett J, one of the consequences or advantages, rather than the effect, of the transaction.

On appeal, Lloyd LJ held that to invoke this jurisdiction, there must be a mistake on the part of the donor either as to the legal effect of the disposition or as to an existing fact which is basic to the transaction. Moreover, the mistake has to be of sufficient gravity as to satisfy the *Ogilvie v Littleboy* test. This test provided protection to the recipient against too ready an ability of the donor to seek to recall his gift. The fact that a transaction gives rise to unforeseen fiscal liabilities is a consequence, not an effect, for this purpose, and was not sufficient to bring the jurisdiction into play.

Neither Mrs Pitt nor her advisers applied their minds to the question of whether, and if so how, IHT might affect the transaction. On the other hand, Mrs Pitt was advised that there were no adverse tax implications of what was proposed. A belief or assumption in general terms which was false in one material respect, even if not in others, seemed to Lloyd LJ to suffice as a mistake for these purposes. He disagreed with Robert Engelhart QC on this. Mrs Pitt ***was*** under a mistaken belief of this sort at the time of the transaction. Overall, he held that, even though Mrs Pitt was under such a mistaken belief, which was a mistake of sufficient gravity to satisfy the *Ogilvie v Littleboy* test, nevertheless it was not a mistake as to the legal effect of the disposition, and therefore the transaction stood.

Discussion

The formulation of *Hastings-Bass* which has been adopted by the CA curtails the ability of trustees to extricate themselves from transactions based on incorrect tax advice. In *Hastings-Bass* itself, the CA posed the question of whether the trustees had failed to ask themselves the right questions or to arrive in good faith at a reasonable conclusion. In my view, the *Pitt* and *Futter* cases conflict with *Hastings-Bass*. A capricious or perverse decision of trustees ought to be capable of being set aside without the Court having to find that there has been a breach of trust or fiduciary duty, even if the reason for the capriciousness or perversity is the trustees' mistake as to the tax consequences or their failure to consider it at all. Moreover, the taking of flawed advice should not mean that there is no breach of duty – even if it would afford the trustees with a defence if sued for compensation. The *Pitt/Futter* decision gives rise to the odd result that transactions by trustees who fail to take any advice at all may be easier to set aside than those made based on incorrect tax advice.

As to mistake, the characterisation of tax mistakes as mere "consequences" will make it difficult for donors or settlors to extricate themselves, unless the nature of the transaction itself has also been misunderstood. See, eg. *Bhatt v Bhatt* [2009] STC 1540, which was one such case (in which I appeared for the widow), where a deed of variation and settlement not only had unwelcome IHT effects but took away a widow's ability to control who lived in her family home.