

Court Unwinds Trustee's Taxation Misstep

Maples and Calder, the Maples Group's law firm, acted for the trustee of three Cayman Islands trusts in relation to a successful application by the trustee under section 64A of the Cayman Islands Trusts Act (2021 Revision) (the "Trusts Act"), which is a statutory version of the 'rule' in *Hastings-Bass*, effectively permitting the court to unwind errors made by trustees. Kawaley J's judgment in *Re Settlements made by Declarations of Trust dated 9 May 2013*, FSD 228 of 223 (28 September 2023) ("*Re: Settlements*"), is the first published decision applying this relatively new provision.

Background to Section 64A of the Trusts Act

The rule in *Hastings-Bass* was traditionally a flexible principle that enabled the court to set aside a trustee's exercise of their powers under the terms of the trust, where the effect of the exercise of power was different from what they intended. This relief was available if the trustee would not have exercised the power as they did, but for their failure to take into account relevant considerations, or their having taken into account irrelevant considerations. This has been a powerful remedy to address mistakes by trustees and has often been deployed to undo transactions having unforeseen and significant adverse tax consequences.

However, the scope of the rule was (comparatively) recently narrowed by the UK Supreme Court in *Pitt v Holt* [2013] UKSC 26, which provides that the *Hastings-Bass* rule can only apply where the trustee's error is sufficiently

serious as to amount to a breach of fiduciary duty. In that case, because the trustees had acted on professional advice that turned out to be wrong, there was no breach of duty, and so relief was not available under the rule in *Hastings-Bass*. This meant that, in one of the two cases under consideration, a significant capital gains tax incurred by the trust funds as a result of incorrect advice could not be avoided.

Following this decision, various offshore jurisdictions, including the Cayman Islands, have introduced legislation designed to override the effect of *Pitt v Holt* and to restore the traditional wider jurisdiction of the court to set aside the exercise of fiduciary powers on the grounds of inadequate deliberation. In the Cayman Islands, section 64A of the Trusts Act was enacted in 2019.

Background to the Proceedings

Re Settlements relates to the settlement of shares in a company on three family trusts. When the shares were settled on the trusts, neither the settlors nor the then trustees (who were unremunerated lay trustees) sought advice regarding the tax implications, in the settlors' onshore domicile, of the settlements. Almost 10 years later, when Maples Trustee Services - a professional trustee - was appointed and sought tax advice, it was discovered that these settlements had given rise to a significant unforeseen tax liability, both for the settlors and for the trust funds. Accordingly, the trustee applied for an order under section 64A of the Trusts Act declaring the settlements void *ab initio* and consequential orders.

Kawaley J's Decision

Kawaley J granted the orders sought and, noting that there were no reported decisions applying section 64A, gave his written reasons for doing so.

At a high level, Kawaley J found that section 64A is intended to facilitate a flexible approach to setting aside the flawed exercise of fiduciary powers, and the Court will generally be obliged to give effect to this important legislative purpose, subject to appropriate limitations informed by the facts of each case. However, applicants will still need to cross some hurdles, including in particular that:

- (a) the Court must find facts that would have amounted to the improper exercise of a fiduciary power (in the sense that either relevant matters were ignored, or irrelevant matters were taken into account). In some cases, this may be practically indistinguishable from establishing a breach of the fiduciary duty of due deliberation – but doing so is not of itself a requirement under section 64A.
- (b) provisionally and subject to further analysis in later cases, there is an implied requirement the applicant has acted in good faith in relation to the impugned transaction and has not deliberately pursued a course of conduct designed to gain some undisclosed and impermissible onshore tax advantage, nor indeed designed to procure any other improper benefit.

Importantly, if the flawed exercise of fiduciary power is set aside, it is explicitly void and not merely voidable.

Finally, the case before Kawaley J concerned an application by the trustee. Under section 64A(5), an application may also be made by a beneficiary, enforcer, holder of the fiduciary power, the Attorney-General or, with the leave of the Court, "any other person". Kawaley J was careful to note that different considerations from those covered by his analysis may well apply if the applicant is not a trustee.

Further Assistance

For further information, please reach out to your usual Maples Group contact or the persons listed below.

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