

## Dealing with HMRC Investigations into offshore accounts

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A recent decision of the Guernsey Court of Appeal brings into focus the role of HM Revenue & Customs (“HMRC”) in trust proceedings before the courts of offshore financial centres and the two century old rule that foreign revenue authorities cannot seek to enforce their revenue laws outside their own borders.

#### The facts

In *Gresh v RBC Trust Company (Guernsey) Limited the applicant*, (“A”), who was the beneficiary under a pension scheme administered by the trustee of his pension trust, brought the first application to the Royal Court of Guernsey for *Hastings Bass* relief. The application was made to correct a mistake that occurred when the trustee of the pension scheme relied on tax advice that HMRC says gave rise to adverse tax consequences for A in the UK.

HMRC applied to be joined as a party to that application but its application was rejected by the Royal Court at first instance. HMRC then appealed the decision of the Royal Court.

On appeal, the Court of Appeal has allowed HMRC to be joined as an intervener in Guernsey proceedings regarding the development of *Hastings Bass* principles in this jurisdiction.

#### The principle in *Hastings Bass*

The principle in *Re Hastings Bass* [1975] Ch 25 developed to provide trustees and beneficiaries with an alternative remedy where certain types of mistakes have been made in the administration of a trust. The development of this principle went against the long established

doctrine that the courts would not interfere with the discretionary decisions of a trustee. In *Hastings Bass*, the English Court of Appeal set out certain exceptions to that general rule one being that the Court could interfere where it was clear that the trustee 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. In those circumstances, the court might be prepared, in the exercise of its discretion, to declare the decision of the trustee void *ab initio*.

This principle has been applied in England, Jersey and other offshore jurisdictions, including to correct mistakes made which have unintended adverse tax consequences for beneficiaries.

A, in his application against the trustee sought a declaration that the decision to make distributions from the pension fund to him in the manner it did be declared void *ab initio* as had the trustee acted on correct tax advice it would have structured the payments in another, more tax effective, way.

Following prompting by the English courts in 2006, HMRC issued a position paper in Tax Bulletin No 83 dated June 2006 where it set out its intention to take a more active role in *Hastings Bass* applications. Its intervention in A's application (in Guernsey) is (so far as we have been able to find out) the first time that HMRC has sought to intervene in an application of this type anywhere in the world since it issued its change of policy in 2006.

## Issues before the Court of Appeal

In deciding the appeal brought by HMRC against the decision of the Deputy Bailiff not to allow HMRC to intervene in the proceedings, the Court of Appeal was asked to resolve:

- whether, for the purposes of Rule 37 of the Royal Court Civil Rules, 2007 there existed a question or issue arising out of or relating to or connected with any relief or remedy claimed in the proceedings between A and the trustee which would make it just and convenient to determine between HMRC and A in the same proceedings in Guernsey; and
- importantly, whether or not HMRC's application to intervene was an attempt, contrary to the established law, to indirectly enforce the revenue law of the UK in Guernsey.

The Court of Appeal held that the issues between A and the trustee were the same as the issues between A and HMRC as they both centred on whether or not the distribution made to A was valid or void. The Court of Appeal held that HMRC had a direct interest in the subject matter of the action, namely the validity of the distributions.

The Court of Appeal in reaching its decision disagreed with the approach taken by the Royal Court of Guernsey at first instance and also with the Royal Court of Jersey's decision in *Re Seaton Trustees Limited* (unreported, 19 March 2009) and held that HMRC's interest was a direct

one in the validity or otherwise of the distributions and not merely in the taxation consequences that might flow from the matters to be resolved in the proceedings before the respective court.

The second issue, and perhaps the most important, was the Court of Appeal's finding that the intervention of HMRC would not amount to an attempt to directly or indirectly enforce the revenue laws of the UK outside its borders. Importantly, the Court of Appeal noted that if what HMRC was attempting to do was enforce UK revenue laws in Guernsey then it would not have been allowed to intervene.

In reaching its decision, the Court of Appeal held that what HMRC was attempting to do was to obtain a ruling in Guernsey which could be then used to determine A's tax liability in the UK. The Court held that it was neither directly nor indirectly enforcing UK revenue law. HMRC was simply seeking to resolve an issue which may be important to HMRC in due course in enforcing UK revenue laws within the UK.

## Commentary - What does this mean?

HMRC can now join into potentially every Hastings Bass application which might have UK tax consequences. It follows that any foreign revenue authority can intervene in Guernsey Hastings Bass applications if the outcome might have tax consequences in that foreign state.

It might be possible for foreign revenue authorities to argue to expand on this decision and seek to intervene in other applications in due course where there might be tax implications. Applications to rectify or vary the terms of a trust are obvious examples where HMRC has generally not wished to take part (as used to be its policy in Hastings Bass applications) but it remains to be seen whether its policy in relation to these applications might now be reconsidered.

The fact that foreign revenue authorities can now take part in some trust applications and the risk that this might "creep" into other areas will be of concern to settlors and trustees. It will be a matter they will want to consider when deciding whether to create trusts in Guernsey or other offshore jurisdictions. The costs of any application where a foreign revenue authority takes part are bound to be significantly more than otherwise and it will take longer for applications to be determined.

There is also an increased risk that rather than applying to the Court for *Hastings Bass* relief or rectification, a more attractive option might be to sue the trustee and other advisers for the consequences of what has happened. Whilst in many cases actions for professional negligence will not "cure" the problem in the way Hastings Bass relief or rectification would, that might be a more attractive option to disgruntled beneficiaries or settlors than making a court application into which a foreign revenue authority might seek to take part and take a greater investment of both time and money to reach a conclusion. If that happens, it will also make insurance

premiums in the industry more expensive.

## Does this affect other jurisdictions?

The Court of Appeal decision in Guernsey does not bind other jurisdictions to take the same approach. However, it will be persuasive elsewhere especially in jurisdictions where the rules on the joinder of parties are the same – as is the case in Jersey. In addition, the judges of the Guernsey Court of Appeal who decided this case also sit on the Jersey Court of Appeal. It is very unlikely that they would reach a different conclusion should a similar case go before them in that jurisdiction.

Note: A appealed to the Judicial Committee of the Privy Council for special leave to appeal but special leave was refused.

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