The Offshore Taxation Review

A NOTE ON LEON SARTIN'S 'TAX RECOVERY CLAIMS BY THE SETTLOR'

Robert Venables QC[1]

In an article 'Tax Recovery Claims by The Settlor,' in *The Personal Tax Planning Review* Volume 6 Issue 3, Leon Sartin, a Lincoln's Inn barrister, considers whether or not trustees are bound or entitled to satisfy a claim by the settlor of a trust for reimbursement of capital gains tax he has been compelled to pay the UK Inland Revenue, pursuant to the Offshore Settlor Provisions. The settlor is given a statutory right of indemnity which will, of course, be enforceable in the UK. As Mr Sartin points out, " any trusts will have been set up for the benefit of the settlor's children and remoter issue with the settlor expressly excluded from benefit. More often than not, the settlor's ongoing tax liability will not have been provided for in the trust instrument. Trustees may not therefore have power to make payments to the settlor and so the question arises as to whether or not the settlor's right of recovery is enforceable." The problem is becoming a more acute one with the abolition of the non-qualifying status of most "golden" trusts.[2]

Mr Sartin of course acknowledges "the well recognised principle of international law that the courts of one country will not enforce the tax laws of another country. The leading case is the decision of the House of Lords in *Government of India v Taylor,*[3] where it was held that a foreign State cannot make a direct claim for tax, so that (on the facts) it cannot prove in the liquidation of an English company in order to claim tax." Mr Sartin also acknowledges that "the same applies to indirect claims where the foreign State (or its nominee) in form seeks a remedy, not based on revenue law, but which is in substance designed to achieve the same effect. For example, the rule applies to a claim brought by the liquidator of a foreign company, if the only creditor

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2 See my article in this issue *'Golden Trusts: Action Prior to 6th April 1999.'*

3 [1955] AC 491.

is a foreign revenue authority (*Peter Buchanan Ltd and Macharg v McVey* noted at [1955] AC 516), but not where there are other creditors (see, for example, *Le Marquand and Backhurst v Chiltmead Ltd (by its Liquidator, Halls)* (1987-88) JLR 86). Accordingly, a foreign court will not normally give leave to trustees to make payments to the UK from trust assets situate in the foreign country if the only purpose for those payments is to meet a UK tax liability: see *Scottish National Orchestra Society Ltd v Thomson's Executor*[4], although the courts did in *Re Reid* (1970) 17 DLR 3d 199 and *Re X's Settlement* 1994, unreported, Royal Court of Jersey, Butterworths *Offshore Cases and Materials*, 1996, p.608."

He rightly points out that the case of the settlor who is seeking an indemnity from offshore trustees for tax he has been compelled to pay is distinguishable from a claim by the UK Commissioners of Inland Revenue themselves:

> "The tax liability is, of course, that of the UK settlor not the offshore trustees. The settlor is not a nominee of the UK government. He will have already paid the tax and is simply seeking reimbursement for it. However, it may be the case that enforcement of the settlor's right of recovery would be seen as indirect enforcement of UK tax law. By treating offshore gains as taxable in the hands of the settlor, the UK government is doing indirectly what it cannot achieve directly. One view is that foreign trustees are themselves (in effect) being taxed, albeit with payment being made to a third party: the settlor. The short issue is whether there is any material difference between a tax claim and an indemnity claim in respect of tax.
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> "One important difference is that there is no revenue claim which would otherwise be unsatisfied. The settlor is not the equivalent of the liquidator in that sense. This may mean that the rule will not apply: see the decision of Lord Mackay at p.440H-441A in *Williams & Humbert Ltd v W & H Trade Marks (Jersey) Ltd* [1986] AC 368 (and also *Re Reid* (1970) 17 DLR 3d 199, 205, not followed in *Stringam v Dubois* [1993] WWR 273). However, the case concerned the enforcement of company law claims following a foreign decree of expropriation. It did not relate to tax, though tax cases were relied on in argument. Moreover, a House of Lords decision is not binding authority in the jurisdictions likely to be hearing cases of this type."

Mr Sartin's view, with which I heartily concur, is that "there is little difference between tax claims and indemnity claims in respect of tax. It is extra-territorial in the sense that the settlor's indemnity claim, like tax claims, depends wholly and exclusively on UK tax legislation and nothing else."

4 (1969) SLT 725.

This is an extremely difficult area, where it is impossible to be dogmatic. I would myself respectfully differ from Mr Sartin's statement: "The tax liability is, of course, that of the UK settlor not the offshore trustees. The settlor is not a nominee of the UK government." I append to this note an extract from my *Non-Resident Trusts* at 13.10.4, in the context of the discussion of double taxation treaty relief.

I note that if the indemnity is enforceable abroad, it would be an easy matter for the UK Parliament to impose on any third party a liability which it could *de facto* enforce, and to give that third party a right of indemnity against a person outside its jurisdiction it in fact wanted to but could not tax. Is a matter of public policy to come down in 1999 to a question of form rather than substance?

Mr Sartin alludes to a possible point of distinction: would the indemnity be enforceable if the offshore trust is governed by UK proper law, even if it would not otherwise be enforceable? Mr Sartin appears to suggest that it would:[5]

> "This may be contrasted with, say, powers of investment implied by the UK's Trustee Investment Act 1961. They are not forced upon the trust in the same way as the settlor's statutory right to recovery. The system of law which governs the trust is chosen (as the Recognition of Trusts Act 1987 and Hague Convention make clear) by the settlor and accepted by the trustees when they take office.
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> "Where the proper law of the trust is the law of a territory outside the UK, it may well be the case that the foreign courts will not allow UK legislation to interfere with the rights of the beneficiaries under the settlement (see *Re Latham* [1962] Ch 616, 639), for example, by not allowing distributions to be made to someone who is not a beneficiary. As a further point, Paragraph 6 of Schedule 5 necessarily imposes a liability on foreign trustees. It may be that the UK Parliament is not competent to legislate in such a manner as a matter of constitutional (as opposed to private international) law."

I myself would not consider that the proper law of the trust would be material when one is concerned with penal or confiscatory legislation. The argument that it should be is stronger where the taxing provision is already in force when the trust is created or, at least, exported from the UK. The scandal of the extension of the Offshore Settlor Provisions to trusts which were already non-UK resident prior to 19th March 1991 is that tax charges are being in a sense retrospectively imposed on settlors and trustees. However, the contrary view is certainly not unarguable and trustees who exercised a power to change the proper law of their trust or to transfer trust assets to

3 The passage here quoted follows on immediately from the last quotation. The opening words are part of the same paragraph as the words last quoted.

the trustees of a new trust governed by a non-UK proper law would no longer have to deal with that argument.

The position of professional advisers is a very delicate one. There is in my view nothing to prevent them from giving advice as to the existing position or replying to express questions as to the future position on various factual hypotheses. I would generally caution against an adviser giving advice as to how the UK Revenue could be prevented from recovering tax due, as the Revenue would have an excellent argument that that amounted to the serious common law offence of cheating Her Majesty's Revenue. At least if two or more persons were involved, as they inevitably would be, there is a good chance that the UK courts would hold that the conspiracy to cheat would be indictable in the UK no matter where the conspiracy actually took place. Where the advice is on how to deprive the settlor of obtaining an indemnity for tax paid by him, it would logically follow that there is no cheating of the Revenue. Even that logic would arguably be flawed where the settlor would, after meeting one tax demand, otherwise be insolvent and incapable of meeting a future demand. One cannot, alas, count on logic taking one all the way in a criminal court - at least, the sort of logic we are used to in the Chancery Division. No client is worth risking going to gaol for.

Leon Sartin does discuss in his article the possible solution of the trustees obtaining authorisation from an appropriate foreign court to make payments to UK settlors. Much may depend on the relevant jurisdiction. An application which would be doomed to fail if made, say, in the High Court in London, could possibly succeed in a more relaxed jurisdiction. He also gives pragmatic advice to trustees under the heading "Protecting Your Position As Trustee".

***Venables on Non-Resident Trusts* 7th Edition**

13.10.4 Double Taxation Relief of Trustees[6]

Suppose that the trustees are residents of Contracting State B for the purposes of a double taxation arrangement between that State and the UK. Under the double taxation arrangement they are exempted from UK capital gains tax in respect of all the gains they have actually realised during the year of assessment. The settlor himself cannot rely directly on the double taxation arrangement. In my view, there is a very respectable argument that the settlor can rely indirectly on the double taxation arrangement.

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4 The argument in this section is independent of, and rather stronger than, that mentioned in 13.7.1.3.3.

Looking at the matter, as modern courts like to do, as one of substance rather than form, it is quite clear that the Schedule levies capital gains tax on the trustees and not the settlor. True, the measure of the capital gains tax payable is determined by reference to the settlor's personal tax circumstances. True also, that in the first instance it is the settlor who is liable to pay the tax to the exclusion of the trustees who cannot be assessed directly. Yet at the end of the day, provided the machinery of the Schedule works properly, it is the trustees who will pay the tax. It is thus in substance borne by them and the whole of the Schedule is mere machinery used to calculate the rate of tax and facilitate its collection by the Revenue. Viewed in this light, is it not clear that the double taxation arrangement, and the relevant enabling UK legislation, effectively prevent tax being recovered from the trustees in such a case? Is it therefore not equally clear that the settlor cannot be made liable in the first place as his liability would be transformed from a mere representative and secondary liability into an entirely new primary and definitive liability?

Put the argument another way. Suppose that the settlor is assessed under the section, pays the tax and recovers it from the trustees. What is to prevent the trustees making a claim for relief and for repayment of the tax under the double taxation arrangement?

If this argument is correct, it is crucial that the gain should actually be relieved from UK capital gains tax under the terms of the double taxation arrangement. It is not enough that, the Schedule apart, the trustees would not be liable, simply because they did not satisfy the residence test laid down in Taxation of Chargeable Gains Act 1992 section 2(1). The precise wording of the relevant double taxation arrangement will be crucial.[7]

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5 See my *Capital Gains Tax Planning for Non-UK Residents*, Chapter 5.