BARRING A RECOVERY, AND OTHER TAXING NOTIONS

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Introduction

In the last issue of this *Review*,[2] Leon Sartin discussed the recoverability, in a non-UK court, from non-UK resident trustees, of the value of tax paid in the UK by the UK resident settlor, pursuant to the statutory right of reimbursement contained in Schedule 5 paragraph 6 of the Taxation of Chargeable Gains Act 1992. Mr Sartin considered two principal arguments against recovery. The first derived from the well-known rule of private international law that a claim to enforce a tax or penal liability imposed by one state will not be entertained or enforced in the courts of another state. The greater part of his article was devoted to this argument. The second argument was dealt with much more shortly. It is that:

(i) it is not possible for UK legislation to alter the rights of beneficiaries under a non-UK law trust;

(ii) enforcing the statutory right of reimbursement amounts to an interference with those rights; and hence

(iii) in the case of a non-UK law trust this UK legislation will not be enforced.

There was also a subsidiary point relating to the constitutionality of the UK Parliament legislating in relation to foreign law trusts.

Mr Sartin's view was that the first argument was effective to bar the recovery by the settlor of the value of the tax paid. He reached no concluded view on the second argument, though the language he used ('it may well be') appeared to favour the

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2 Vol 6, No 3, pp 237-239 (the paragraph intended for p.240 was omitted in error).

same result. Curiously enough, at almost exactly the same time as Mr Sartin's article appeared, an article of mine on the same subject was published in the *Jersey Law Review*.[3] My article was, however, less comprehensive than Mr Sartin's, in that it dealt with only the first of the two arguments mentioned above. It did not mention the second. Since Mr Sartin's article was published, a further article on the same subject, by Robert Venables QC, has appeared in the *Offshore Taxation Review*.[4] That article, too, only dealt with the first argument, and not the second.

I have the misfortune to differ from Mr Sartin on both arguments, and (at least in part) from Mr Venables QC in relation to the first of them. There is little point in setting out my reasons in relation to that argument, as these are now in print, and readers are directed to my article.[5] But I should like here to explain why I think that the second argument is also misconceived.

Re Latham

The sheet anchor of the argument is, as Mr Sartin says, a case called *Re Latham*.[6] A settlement had been made in 1931 with a Canadian proper law (which province was unclear). In the events that happened, a share in this fund was held on trust for the settlor's wife for life, with remainder (as to part of that share) for the settlor's son, Paul, for life, with remainder over to Paul's son, Richard, absolutely. Both the settlor and his wife died domiciled in England. The UK estate duty on the share passing to Paul was never paid. Paul also died domiciled in England, and a deduction was claimed from his estate for the amount of the estate duty payable by Paul on the death of the settlor's wife. The Inland Revenue resisted that claim on the basis that the estate duty payable by Paul was a debt in respect of which there was a right of reimbursement, in accordance with Finance Act 1894 s.7(1)(b).

The question over which there was litigation was, therefore, whether the obligation which Paul had, to pay the estate duty in respect of the share of the fund which came to him after his mother's death, was a debt in respect of which he had a right of reimbursement. It was argued by the Inland Revenue that s.9(6) of the Finance Act 1894 conferred upon Paul's estate a right of reimbursement out of the capital of Paul's share in the trust fund. This provision read:

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3 Vol 3, no 1, February 1999, pp 56-72.

4 Vol 8 No 3, pp 239-245.

5 See note 3 above.

6 [1962] 1 Ch 616.

> "A person having a limited interest in any property, who pays the estate duty in respect of that property, shall be entitled to the like charge, as if the estate duty in respect of that property had been raised by means of a mortgage to him."

Wilberforce J, in a lengthy extempore judgment, held that s.9(6) did not in the circumstances of this case confer a right of reimbursement on Paul's estate. He said:[7]

> "What I have here is a Canadian settlement, or a settlement whose proper law is that of one of the provinces of Canada, and, if that is so, the rights of the beneficiaries under that settlement and the rights in respect of the trust property must be governed by the proper law of the settlement, which would be the law of Canada or of the appropriate province. It seems to me that if they have rights of that character it would not be possible for a piece of English statutory legislation such as this to interfere with those rights, and to confer upon one of the beneficiaries under the settlement a charge over the trust property inconsistent with the rights which the beneficiaries have under their own law."

We should, incidentally, note that the particular legislation which the judge was considering on its face purported to create a charge. It was not merely a personal right of reimbursement. In particular, the trustees were not made personally liable. We should also note that, in the particular case, the taxpayer under consideration, who would obtain the charge, *was a beneficiary*. So one beneficiary would obtain a proprietary right in trust assets adverse to the interests of other beneficiaries. Factually speaking, this case is rather different from the typical case under Schedule 5 paragraph 6 of the 1992 Act, where the right is personal, not proprietary, is conferred on a person who is not (or at any rate need not be) a beneficiary, and is against the trustees rather than any beneficiary.

First Response: does it alter the beneficiaries' rights?

There are, I think, two answers to the *Re Latham* argument when it comes to the 1992 Act: one which applies generally, whatever the (non-UK) proper law of the trust, and the other which applies in the case where the trust concerned is governed by a proper law from one of some (but not all) offshore jurisdictions. The general point is this. The objection is to a UK statute which purports to alter the beneficiaries' rights under a foreign law trust. One can understand that, if there is

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7 [1962] Ch 616, 639.

a trust governed by a law of New York, the beneficiaries' rights as between themselves and as against the trustees are to be governed by that law, and not by English law. Accordingly, if an English statute purported to declare that for the future a life tenant under a New York trust was to have the option of commuting his or her interest for a 20% interest in the capital, that would undoubtedly be ineffective, certainly so far as courts outside the United Kingdom were concerned, and *Re Latham* is authority for saying it would also be ineffective inside the United Kingdom. But this depends on the statute in question being characterised as one which purports to change the substantive rights of the beneficiaries inter se or against the trustees. It is well settled, for example, that even where a trust or estate is to be governed by a foreign proper law, English law may still apply, for example in matters of administration, if the trust happens to be being administered in an English forum.[8]

But the Taxation of Chargeable Gains Act 1992, in conferring a right of reimbursement on the settlor in respect of capital gains tax, is not only not a statute purporting to alter the substantive rights of the beneficiaries, it is not even concerned with the internal workings of the trust at all.[9] Not only does the right not purport to confer a charge on trust property (and so is not proprietary in operation), but neither does it confer any rights on any beneficiaries as such. Instead, it confers personal rights on a person who is, after the constitution of a trust, a stranger to it, a third party. And those rights are rights against the *trustee*, not against the *beneficiaries*. The cases[10] on which Wilberforce J relied in *Re Latham* to justify his conclusion were contract cases, not trust cases. The question in those cases was whether Australian withholding tax legislation could affect the right of an English domiciled party to an English contract to receive the sums stipulated for by the contract from the other (English) party, who earned the monies in Australia and found himself caught by a local law. The courts held that it could not. Those cases were not concerned (for example) with whether the Australian tax man could sue the person earning the money in Australia.

Let me test the question in this way. Suppose that a Jersey trustee of a Jersey trust and the (UK) settlor of the trust each sells shares in a UK private company to a UK

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8 See e.g. *Re Wilks* [1935] Ch 645 and *Re Kehr* [1952] 1 Ch 26, cases dealing with the power of postponement of sale in s.33 Administration of Estates Act 1925, the power to appoint trustees under s.42 of the same Act, and the powers of maintenance under s.31 Trustee Act 1925.

9 cf *Re Wilks* and *Re Kehr*, note 8 above.

10 *Spiller v Turner* [1897] 1 Ch 911; *London & South American Investment Trust Ltd v British Tobacco Company (Australia) Ltd* [1927] 1 Ch 107.

purchaser of such shares. There is a single contract, governed by English law, and the settlor and the trustee give joint and several share warranties. Let it be assumed that subsequently the purchaser wishes to bring an action on those share warranties. The settlor (but not the Jersey trustee) has assets in England. The English purchaser brings an action against both defendants in England, obtaining leave to serve out of the jurisdiction on the trustee. The settlor fears that, if he does not defend in England, a judgment will be obtained which will be executed on his assets in England. The Jersey trustee having no such assets does not seek to defend, but relies on the fact that the judgment obtained in England will not in fact be enforceable against the trustee's assets in Jersey.[11] If the English purchaser is successful against the settlor in the English action, the settlor may then seek to obtain a contribution from the Jersey trustee in Jersey. He sues the trustee *in Jersey* on the statutory cause of action created by the (UK) Civil Liability (Contribution) Act 1978.

In my article in the *Jersey Law Review*, dealing with the 'foreign revenue' argument, I concluded that the Jersey court would not refuse to enforce a statutory cause of action merely because it came from an English statute.[12] Plainly, a claim to contribution in itself is not the enforcement of a foreign revenue law. But could it be objected, on behalf of the Jersey trustee, that this English statute is purporting to affect rights of the beneficiaries under a Jersey law trust, and for *that* reason ought not to be enforced? It seems to me that the answer must be No. This is an attempt to fix the trustee with liability towards a third party. If the trustee is liable, the question may then arise as to whether the trustee is entitled to be indemnified out of the trust fund (on the basis of having acted properly, and so on). But that is not the same as saying that the statute is in any way designed to regulate or alter the rights of the beneficiaries amongst themselves or as against the trustees. It is not concerned with what happens *inside* the trust, but with what happens *outside* it. The same is true in relation to the reimbursement of tax already paid by the settlor. For these reasons, therefore, I conclude that the *Re Latham* objection does not apply to our case.

Second Response: is the UK Parliament incompetent?

But we should notice another problem with this objection, which applies when one is dealing with a trust governed by the law of any offshore jurisdiction which is still a British colony or dependent territory. Even if I am wrong in the previous paragraphs, and if the legislation introducing the settlor's right of reimbursement is

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11 See the Judgments (Reciprocal Enforcement)(Jersey) Law 1960, Art 6(i)(a)(ii), (2); *Adams v Cape Industries plc* [1990] Ch 433, 550.

12 See (1999) 3 JL Rev 56, 59.

to be regarded as purporting to make changes to the rights of beneficiaries under a foreign law trust, it must be noted that this is legislation emanating from the Westminster Parliament (which used to be called "Imperial"), and that this parliament *retains the right to legislate for the colonies and dependent territories*.[13] For example, in the Channel Islands there remains no doubt that, although each of the Bailiwicks has its own legislature, the Westminster Parliament can still legislate laws directly applicable to those places, which then form part of the local law.[14] Sometimes statutes do not apply directly, but only once an Order in Council has been made thereafter, which may also make modifications.[15] Moreover, the Westminster Parliament may change the law in colonies and dependent territories by applying, not the *whole* of the Act to those territories, but merely some of the provisions in it.[16] Even if (as is sometimes claimed) there is a convention that the Westminster Parliament does not legislate for dependencies without their consent, a Westminster Act passed without such consent would not be invalid.[17]

Thus the UK statutory provision conferring a right of reimbursement on the settlor, even if it *did* amount to purporting to vary the beneficiaries' rights under trusts in colonial jurisdictions governed by the laws of those jurisdictions, would constitutionally be capable of changing, and might well change, the domestic trust law of those jurisdictions in relation to such trusts. (We may note that the cases[18] relied on by Wilberforce J in *Re Latham* were cases of Australian colonial legislation. In nineteenth century Britain, the notion that the legislation of a mere *colony* could affect the rights of *English* domiciled contracting parties would have been regarded as absurd; not so, the other way round.)[19]

One problem with this answer to the objection is that, if it is true in relation to *current* colonies and dependent territories, it was true in relation to Canada in 1894.

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13 *Royal Commission on the Constitution*, 1969-73, Report, Vol 1, Part XI, paras 1471-1472.

14 These include the Alderney (Transfer of Property etc) Act 1923 and the Extradition Act 1989 (see s.29(1)).

15 For example, there are the Evidence (Proceedings in other Jurisdictions) Act 1975, the Civil Aviation Act 1982, and also the Recognition of Trusts Act 1987 (although this route was not used to extend the Act to the Channel Islands, they having introduced their own legislation; it was however used to extend it to other colonies).

16 For examples, see the Trustee Act 1925, s.56, and the Bankruptcy Act 1914 s.122.

17 cf *Pickin v British Railways Board* [1974] AC 765 (allegation that Act obtained by fraud).

18 See note 10 above.

19 Cf *Oteri v R* [1976] 1 WLR 1272.

Despite the existence of local legislatures, the Imperial Parliament at Westminster theoretically retained the right to legislate for Canada until the enactment of the Canada Act 1982, by which it gave it up.[20] Yet in *Re Latham* no trace can be found of such an argument. But all this demonstrates is that nobody thought of the point. The judge seemed to assume that it was not competent for the UK parliament to legislate for Canada, which was not true, as the Canada Act 1982 proves. However, since the point was not discussed, or even adverted to, *Re Latham* is hardly a strong authority against it.

Third Response: what about the local law?

Lastly, there is this point. If, contrary to what has gone before, the statutory right of reimbursement *can* be objected to on the grounds that it purports to change the rights of beneficiaries of trusts governed by a non-UK law, it is still necessary to go on and consider whether, under the proper law of the particular trust, there is not some equivalent right of reimbursement, perhaps under the law of restitution or something similar to that. This was (curiously enough) precisely what happened in *Re Latham* itself. The judge went on, at the end of his judgment, to consider whether, under the *Canadian* law applicable to the trust, if a beneficiary having a limited interest in a trust paid a tax attributable to the whole trust, he would *under that law* have a right of reimbursement. He concluded that he would, and therefore answered the ultimate question in favour of the Inland Revenue.

He said this[21]:

> "I have heard no evidence as to what the local law is, but it seems to me that, on the basis of the case as pleaded, I must assume that the relevant, the applicable law, to this settlement is the same as English law, although perhaps I may, parenthetically, draw attention to the - in some ways unsatisfactory - consequences which may arise from proceeding in this way.... However, in this particular case, the difficulty is not perhaps very great because all that I am asked to do is to say that the Canadian courts would apply the same sort of broad principles based on plain common sense, which require that, where an obligation manifestly affecting the inheritance and related to the capital of a trust fund falls upon the shoulders of a person with a limited interest, that person should be entitled to come against the capital or the person entitled to it and ask to be reimbursed. That is all that

20 See s.2.

21 [1962] Ch 616, 641-642.

> is being sought here.
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> It seems to me, therefore, that on that assumption which I, in the circumstances, am not reluctant to make, and it being clear to my mind that the principles which have been cited cover this sort of case, that *there is an equitable obligation here under the general law applying to the settlement of property in succession which would entitle, and which should entitle, [Paul] and the bank to claim that such portion of this aggregate sum of estate duty as represents the charge in respect of the capital of the trust fund should be paid to them out of the capital*, and it seems to me that if this debt had been paid in his lifetime by [Paul], there could hardly have been any doubt that he would be entitled to come and seek for reimbursement of the amount which I have mentioned...." (emphasis supplied).

So, in the case of a foreign jurisdiction in which the settlor's right of reimbursement is sought to be enforced, the settlor may also be able to claim a right of reimbursement under the general law. Some jurisdictions may not know any such principle, but others may do so. Most of the British colonies and dependencies follow English trust law precedents (such as *Re Latham* is on this point). So far as Jersey is concerned, I am not aware of any local decision directly in point, but I draw readers' attention to one recent Jersey case[22] where the Royal Court referred to principles of the Anglo-American law of unjust enrichment, and applied them in the context of benefits conferred by mistake. It accordingly appears likely that the Jersey courts will follow the English rules on unjust enrichment, and that therefore the principle enunciated in the English case of *Brooks Wharf and Bulls Wharf Limited v Goodman Bros*,[23] and also the principle just alluded to in the case of *Re Latham*, may well be applied locally. If so, this will mean that there is a principle under the *local* law, which serves the same function as the UK statute granting reimbursement to the settlor, and there is no need for the settlor actually to rely on the statutory right at all. This might not prevent an argument based on the indirect enforcement of a foreign revenue law from succeeding, but it would certainly sidestep any objection that the UK statute was purporting to alter the beneficial entitlement of beneficiaries under a foreign law trust.

Conclusion

Accordingly, I do not agree with the view which Leon Sartin (admittedly tentatively)

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22 *La Motte Garages v Morgan* [1989] JLR 312, 315-316.

23 [1937] 1 KB 534.

put forward in his article, that foreign courts will not enforce the statutory right of reimbursement on the grounds that it purports to alter the rights of beneficiaries under the trust. The first objection which I put forward seems to me conclusive. And, depending on the state of the local law, so may the third be. But, at a practical level, and given the current sensitivity in the politico-legal debate about how far the UK Parliament is entitled to legislate for (say) the offshore British islands without their consent,[24] it may be that the spectre of the second objection I mentioned being raised and decided in an unfavourable sense must make any trustee in a British colony or dependency think twice before seeking to rely on the *Re Latham* argument. He may (or may not) trust his local court to reach the 'right' answer, but does he feel the same about the Privy Council?[25]

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24 See e.g. the *Review of Financial Regulation in the Crown Dependencies*, November 1998, (the "Edwards Report"), available at: www.official documents.co.uk/document/cm41/4109/4109.htm.

25 See e.g. *Douglas v Pindling* [1996] AC 890, 901-902.