

A(voiding) trustees' mistakes: the Hastings-Bass Rule



THE HASTINGS-BASS RULE POTENTIALLY ALLOWS TRUSTEES TO SEEK TO HAVE DECISIONS WITH ADVERSE TAX CONSEQUENCES TREATED AS INVALID.

PROPER DECISION MAKING BY TRUSTEES

A trustee in carrying out the sometimes onerous task of administration of a trust must discharge the following common law duties:

- to become acquainted with the terms of the trust;
- to adhere to and carry out the terms of the trust;
- to act impartially amongst a class of beneficiaries;
- to act in good faith;
- to act independently;
- to keep proper accounts;
- to properly invest trust funds;
- to take reasonable care; and
- to avoid delegating duties or powers.¹

A trustee is placed in a fiduciary position and must exercise care when making decisions. This includes considering relevant issues such as the taxation consequences of those decisions.

However, sometimes no matter how prudent a trustee has been, unforeseen consequences including taxation consequences arise from a series of complex transactions and decisions. What then? Can a trustee “undo” what has been done?

The Rule in the United Kingdom case of *Re Hastings-Bass*² allows trustees to seek the Court’s assistance to reverse decisions resulting in errors including regretful fiscal consequences as a result of their failure to take into account considerations they should have, or due to their having taken into account irrelevant matters.³

The cases involving application of the Rule have largely involved unforeseen taxation consequences of trustees’ decision making. The Rule undoubtedly applies in the United Kingdom, but does the Rule apply in Australia, and if so, in what circumstances?

THE CASE OF RE HASTINGS-BASS

The 1975 case of *Hastings-Bass* was concerned with two trusts. The first trust was created in 1947. It granted Captain Hastings-Bass a life interest in property which upon his death would devolve to his sons by will or deed. By a deed of 1958, Captain Hastings-Bass’ eldest son William was nominated to receive the trust fund at 25 years of age. In 1957, a second trust was established by the Captain’s sister, granting William a life interest in the property of the second trust which would then devolve to his offspring.

The trustees of the first trust were concerned to avoid estate duty. They exercised a power of advancement in 1958 and transferred property from the first trust to the second trust. The Captain died in 1964. In that year the law in England concerning perpetuity changed, and the question arose as to whether the 1958 advancement failed totally due to being void for perpetuity or whether it was in part valid.

If the advancement was effective (even in part), no estate tax was payable, but if it was not, the trustees would face a large tax bill. They applied to the court for a determination as to whether or not estate duty was payable. At first instance they lost. The case went on appeal to the Court of Appeal.

The trustees argued that the advancement was made on good faith, and it was within their statutory powers, and therefore valid. The Inland Revenue Commissioner argued that the trustees’ powers could have only been properly exercised if they had considered all relevant issues, and here the trustees had failed to appreciate “the true nature” of the effect of the advancement. In light of this failure, the Commissioner argued that the trustees could not have exercised their powers validly.

The Court of Appeal determined that the 1958 advancement was valid in part. The trustees had aimed to bestow a number of benefits on William including granting William a life interest. Although part of the advancement failed as it was void for perpetuity, the life interest was validly created.

Lord Justice Buckley (for the Court) stated:

Where... a trustee is given a discretion as to some matter under which he acts in good faith, the Court should not interfere with his action, notwithstanding that it does not have the full effect which he intended, unless:

- (i) what he has achieved is unauthorised by the power conferred on him, or
- (ii) it is clear that he 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.⁴

The above statement has become known as the Rule in *Hastings-Bass*. However the Court in finding that the trustees’ decision was valid in part did not have to apply the Rule.

THE APPLICATION OF THE HASTINGS-BASS RULE IN THE UNITED KINGDOM

Probably the earliest application of the Rule was in *Mettoy Pension Trustees Ltd v Evans*.⁵ This case involved a decision of the trustees of a pension scheme to amend the rules of the fund. One important result of the changes was that upon the scheme being wound up, the surplus would no longer be distributed according to the trustees' discretion, but would be distributed according to decisions of the employer company. The trustees did not realise until later that their decision to change the rules of the fund would have this effect.

The trustees applied to the Court for assistance. The Rule in *Hastings-Bass* was considered. Warner J determined that the Rule was applicable and the Court had to ask itself:

- (1) what were the trustees under a duty to consider?
- (2) did they fail to consider it?
- (3) if so, what would they have done if they had considered it?⁶

Ultimately, Warner J did not need to determine that the trustees' decision was void under application of the Rule, as the employer would be placed in a fiduciary position upon the winding up of the fund, which meant that it was bound by the law to act properly and for the benefit of the beneficiaries of the fund.

The description of the Rule in this case has been described as the first "positive" formulation of the Rule in *Hastings-Bass*.⁷ Warner J also determined that the Rule was not confined to situations involving ineffective decision making by trustees because of changes to the law (as was the situation in *Re Hastings-Bass* due to changes to the law of perpetuity).⁸ Finally, Warner J found that the Rule could lead to the invalidation of only part of a deed (instead of it being void in full), as the remedy had to depend on the "circumstances of the case".⁹

Since *Mettoy*, there have been many cases in the United Kingdom in which the Rule has been cited, and a substantial number in which it has been applied. Examples include the cases of *Green and Ors v Cobham*,¹⁰ and *Burrell v Burrell*.¹¹ *Green and Ors v Cobham* involved a misapprehension regarding execution

of a deed, resulting in a tax bill which the court described as "catastrophic".¹² The Rule was applied to set aside the deed. In *Burrell v Burrell* the trustees of a family trust successfully applied to the High Court of Justice to seek that part of a deed of appointment be set aside. The Court applied the Rule in *Hastings-Bass* on the basis that the trustees had failed to consider the inheritance tax complications of the deed.

The Rule appears to have been further defined by the case of *Abacus Trust Company (Isle of Man) v Barr*.¹³ In this case the Court determined that there must be a breach of duty before the Rule will have application. Lightman J stated:

“ The Rule in the ... case of *Re Hastings-Bass* allows trustees to seek the Court's assistance to reverse decisions resulting in errors including regretful fiscal consequences... ”

In summary the Rule affords to the beneficiaries the protection of a requirement that the Trustee performs its duty in exercising of its discretion, and a remedy in case of a default. In the absence of any such breach of duty the Rule does not afford the right to the Trustee or any beneficiary to have a decision declared invalid because the Trustee's decision was in some way mistaken or has unforeseen and unpalatable consequences.¹⁴

This description of the Rule by Lightman J which includes the requirement of a breach of duty by the trustee, has been the subject of disparaging comment.¹⁵ It is likely that the *Abacus* case¹⁶ does not represent the true state of the Rule.

The 2005 case of *Sieff v Fox*¹⁷ involved two family trusts and capital gains tax. One trust was created in 1971 and the other in 1987. The trustees of the first trust made an appointment and assignment resulting in the property of the first trust being held on trust pursuant to the terms of the second trust. Unbeknown to the trustees at the time, the transaction had a capital gains tax implication.

The trustees applied to the Court of Appeal to have the appointment and

assignment set aside. The Inland Revenue Commissioner declined to be involved in the case. Lloyd J was satisfied that the Rule in *Hastings-Bass* applied although it was noted that the equitable principle of rescission for mistake was an alternative basis for challenge of the trustees' decision.

In the case of *Sieff*, the Court agreed with the notion raised by Parker J in *Green and Ors v Cobham*¹⁸ that trustees are obliged to take into account taxation matters when making their decisions.¹⁹ However the question as to whether the decision of trustees must be declared void (from the outset) or voidable (in part) by the court when applying the Rule was left for determination at another time.²⁰

APPLICATION OF THE RULE IN AUSTRALIA

In Australia, the Rule in *Hastings-Bass* has been raised in few reported decisions.

The Victorian Supreme Court chose not to apply the Rule in the case of *Asea Brown Boveri Superannuation Fund No 1 Pty Ltd v Asea Brown Boveri Pty Ltd*.²¹ The case involved new trustees of a superannuation fund seeking a declaration from the Supreme Court of Victoria that an earlier deed (changing provisions of the trust) made by the previous trustees was invalid. Justice Beach considered that the applicable law relating to when a court will review and overturn a trustee's decisions was found in the Victorian cases of *Karger v Paul*²² and the unreported decision of Justice Hayne in *Esso Australia Ltd v Australian Petroleum Agents' and Distributors' Association*.²³

Justice Beach stated:

I know of no principle of law which permits a trustee to come to the court and say – "Sometime ago I made a decision concerning the trust fund of which I am a trustee in the mistaken

belief that a certain state of affairs existed at that time. Had I then known what I now know I would not have made the decision I did but a totally different one. Because of my mistaken assumption I now ask the court to declare my earlier decision to be invalid".²⁴

Yet it is submitted with respect that this is exactly what the Rule in *Hastings-Bass* would allow. The principle extends beyond trustees coming to court to seek rectification or equitable remedies for mistake.²⁵ However, as the *Hastings-Bass* case is a United Kingdom case, the Victorian Supreme Court was not bound to follow it.

In the case of *Sinclair v Moss*²⁶ the Supreme Court of Victoria accepted that the case of *Edge v Pensions Ombudsman*²⁷ applied which states:

[A] discretionary determination may be impugned if the trustees in making it failed to take into account matters which are relevant, that is, matters which they should have taken into account or which should have affected their decision or where they took into account matters which they should not have taken into account.²⁸

The Court described the Rule in *Hastings-Bass* as a "gloss" to the above rule, and expressed the view that there was "uncertainty" as to whether it applied in Victoria.²⁹

Re Hastings-Bass was cited in the Supreme Court of New South Wales case of *Sayseng v Kellogg Superannuation Pty Ltd*,³⁰ a case involving a challenge to the opinion of a trustee of a superannuation fund with regard to a total and permanent disablement claim. The Court accepted that in some instances involving discretionary decisions of trustees, the Court could substitute its own discretion for that of the trustees.³¹ The Court did not go so far as to apply the Rule.

The Rule was applied by a Judge of the Supreme Court of Western Australia in a chambers application in 2008 involving the Public Trustee's handling of an elderly gentleman's financial affairs.³² The case of *BMD v KWD*³³ involved an application for leave to appeal and a review of the Public Trustee's decision to rely upon a property valuation. The application was brought by "BMD", a son of "KWD", the elderly man whose affairs were being administered by the Public Trustee. A dispute had arisen between KWD and his de facto partner "JID".

KWD and JID had negotiated the sale of land being the Peel Manor House and an associated wedding reception business. An agreement for sale was entered into, which was later reviewed by the Public Trustee. The Public Trustee engaged its own valuer to value the land and business. The valuer concluded that the land and business were worth between \$2 million and \$2.5 million. KWD's son objected to the Public Trustee's use of that valuation – as another valuation placed the value of the land and business at over \$4 million.

Justice McKechnie reviewed a couple of cases which examined when a trustee's decision will be the subject of a Court's review, including *Re Hastings-Bass*. It was noted that there was doubt about the application of the rule of *Hastings-Bass* in Victoria,³⁴ but nevertheless Justice McKechnie applied the Rule as its application was beneficial to BMD. The Court went on to consider the Public Trustee's decision regarding the valuation, but was not convinced that the Public Trustee had failed in its exercise of its discretion to rely on the evidence of the valuer who valued the land and business at \$2-2.5 million.

PROBLEMS WITH THE RULE IN HASTINGS-BASS

Commentators have raised a number of problems with the Rule. The first is that the Rule was uttered by way of *obiter dicta*³⁵ and was not applied in the case of *Re Hastings-Bass* itself. Other problems include its rather shaky expansion, its contrary application to cases involving both family trusts and pension trusts, evidentiary issues (given that trustees are not bound to provide a statement of reasons for their decisions), and the lack of argument in the cases in which it has been applied by the revenue authorities.³⁶

Further the facts in some cases show that poor tax or legal advice was a factor. It has been asked in those cases why professional indemnity insurers³⁷ were not left to pick up the pieces as opposed to courts giving the trustees (and their advisers) an "out" via the application of the Rule.³⁸ The Rule is confusing from a legal jurisprudence perspective as it mixes concepts of public law with the private law area of trusts.³⁹ Finally, the courts have not agreed on the outcome of the application

of the Rule. Will the result be that trustees' decision is void from the outset or is it merely voidable in part? With all of this controversy surrounding the Rule, does it have a future?

THE FUTURE OF THE RULE IN AUSTRALIA

Arguably the application of the Rule in the Western Australian case of *BMD v KMD*⁴⁰ is novel. The United Kingdom cases involve private or family trusts and pension schemes and largely taxation consequences. In *BMD v KWD*, the applicant alleged an error in the decision of the trustee to rely on a particular expert report. The consequence of this decision was fiscal – but the case did not involve taxation consequences.

The trustee in the *BMD v KMD* case was a public not private trustee. Any official Public Trustee is bound by statutory duties which apply to its decision-making over and above the common law duties listed at the outset of this article. Commentators have stated that when the Rule has been referred to in the United Kingdom in a situation involving a trustee in a *quasi*-public trustee role (such as trustee of a pension scheme), the application of the Rule is most apt.⁴¹ This is because trustees acting for beneficiaries to whom they have no natural affiliation and are linked purely by employment or commercial reasons, can surely expect to have their decisions closely scrutinised.⁴²

It follows that public trustees and those in *quasi*-public trustee roles, should be able to seek the court's sanction to "undo" a decision that is erroneous on the facts or unwittingly leads to poor fiscal consequences for the beneficiaries of the trust to whom the trustees are charged to take care of.

Taking this argument a step further, in the United Kingdom and Australia we have a volume of common law applying merely to trusts and trustees. Aside from statutory duties, it is hard to point to common law rules which differentiate between public and private trustees. If the Rule is to apply at all in Australia – it is submitted that it is artificial to differentiate between the classes of trustee to whom it "should" apply, given that the common law itself does not make this differentiation when the duties of a trustee (as listed at the outset

of this article) are considered. The duties apply to all trustees.

Until the Rule in *Hastings-Bass* is considered by the High Court of Australia, the Rule can be said to be of doubted application in Victoria. However given the recent decision in Western Australia, trustees in other parts of Australia may yet be able to seek the court's assistance to "avoid" that which shouldn't have been done by reliance upon the Rule.

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Reference notes

- 1 This list is not exhaustive. See generally: JD Heydon, M J Leeming, *Jacobs' Law of Trusts in Australia* (7th ed, 2006).
- 2 [1975] Ch 25; [1974] 2 All ER 193.
- 3 Trustees who wish to make amends for errors could also possibly seek relief via the equitable doctrines of rescission and rectification of which discussion is beyond the scope of this article.
- 4 *Ibid* at 203.
- 5 [1991] 2 All ER 513.
- 6 *Ibid* 555.
- 7 E.g. see comments of Smellie CJ in *A & Six Others v Rothschild Trust Cayman Ltd* [2004-05 CILR 485] at 488.
- 8 *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 at 554.
- 9 *Ibid* 555.
- 10 [2002] STC 820.
- 11 [2005] EWHC 245.
- 12 Above n 10, at 824.
- 13 [2003] 2 WLR 1362.
- 14 *Ibid* [24].
- 15 See for example the judgment of Justice Mann in *Burrell v Burrell* [2005] EWHC 245.
- 16 [2003] 2 WLR 1362.
- 17 [2005] 1 WLR 3811; [2005] EWHC 1312. This case was described in 2006 as the "current state of play" in the UK by Justice Barrett in his address "The Principle in *Re Hastings-Bass*" for the Law Council of Australia and Leo Cussen Institute, of 23 February 2006.
- 18 [2002] STC 820.
- 19 *Ibid* [86].
- 20 *Sieff v Fox* [2005] 1 WLR 3811 at [82].
- 21 [1999] 1 VR 144.
- 22 [1984] VR 161. It is accepted that this case stands for the proposition that the exercise of a trustee's discretion can be examined only to ask if the discretion was exercised in good faith, giving real and genuine consideration to the matter without ulterior purpose. In other words, if a trustee's decision making was based on wrong information or was unwise, that is irrelevant.
- 23 (Supreme Court of Victoria, unreported, Hayne J, 5 October 1993).
- 24 *Asea Brown Boveri Superannuation Fund No 1 Pty Ltd v Asea Brown Boveri Pty Ltd* [1999] 1 VR 144 at 157.
- 25 Barrett above n 17.
- 26 [2006] VSC 130.
- 27 [2000] Ch 602.
- 28 *Ibid*, [17].
- 29 *Ibid*.
- 30 [2003] NSWSC 945.
- 31 *Ibid*, [74].
- 32 *BMD v KMD* [2008] WASC 196.
- 33 *Ibid*.
- 34 *Per Sinclair v Moss* [2006] VSC 130.
- 35 "A saying by the way", as opposed to the ratio decidendi of a decision or the rationale of a decision.
- 36 See for example, Peter Edmundson, "Setting aside trustees' decisions: How secure is the rule in *Hastings-Bass*?" (2008) 31 *Australian Bar Review*.
- 37 Sir Robert Walker, "The Limits of the Principle in *Re Hastings-Bass*", (2002) 13 *KCLJ* at 179.
- 38 *In Abacus Trust Company (Isle of Man) v NSPCC* [2001] WTLR 953, the trustees were advised to execute a document on the wrong date – which saw an otherwise lawful tax minimisation scheme come undone. However note the comments of Warner J in *Mettoy* at 556, "The duty to take into account all material considerations is that of the trustees. The extent of that duty is not affected by the amount or quality of the professional advice they may seek or obtain".
- 39 Walker, above n 37, 174.
- 40 [2008] WASC 196.
- 41 Edmundson, above n 36, 59.
- 42 See comments of Lloyd J in *Sieff*.