TAX ASPECTS OF BREXIT AND TRUST LAW DEVELOPMENTS

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BREXIT: KEY STATISTICS

1 Brexit

Summary from: “Brexit: impact across policy areas” House of Commons Library Briefing paper No 07213, 26 August 2016 (“the Brexit paper”):

> **3.8 Taxation**
> Taxation is very largely a Member state competence. The implications of the UK lying outside the EU are likely to be less significant for taxation compared with other policy areas.

1.1 *VAT*

The Brexit paper provides:

> The major exception to this generalisation is indirect tax: primarily VAT – for which there’s a substantive body of EU law establishing common rules across member States– and, to a lesser extent, excise duties. It has long been recognised that the harmonisation of indirect taxes across member States is an essential element tithe achievement of an effective Single Market. Unlike most internal market measures, which use qualified majority voting (QMV),the harmonisation of taxation is decided by unanimity. The consequences of the EU's shared competence in indirect tax is most frequently discussed in the context of the UK's limited discretion in setting the rates of VAT on individual goods and services. In addition, many commentators have raised concerns about the UK's ability in the future to maintain its existing range of VAT reliefs (such as the zero rates of VAT which apply to food and children's clothes) from any further harmonisation of VAT law.
> However, the relative importance of VAT to the Exchequer – accounting for around 17% of all government receipts – suggests that future governments would be unlikely to substantially increase these reliefs or abolish the tax, even though leaving the EU would give them this power. Writing in the Tax Journal before the referendum, Ben Jones, partner at Eversheds LLP, noted: "there is no practical likelihood that VAT will be abolished by the UK following Brexit. It is not even the case that it would be necessary to take significant legislative steps to preserve VAT in the UK, given that the EU VAT rules have been mainly implemented by UK legislation". Mr Jones went on to note: "UK governments would have greater flexibility to use changes to the VAT system to further political objectives" (e.g. by widening zero-rating, exemption rules or the use of lower rates).Indeed, during the referendum campaign it had been argued that Brexit would enable the Government to introduce a zero rate of VAT on domestic supplies of fuel and power.

1.2 *Direct tax*

The Brexit paper provides:

> There are no equivalent provisions with regard to other taxes, though all national legislation has to comply with the overarching provisions of the EU Treaty, guaranteeing the free movement of goods, persons, services and capital across the Single Market and

> prohibiting discrimination. There is a substantive body of case law where the Court of Justice of the EU (CJEU) has ruled that individual provisions of a Member State's tax code fail this test. Member States' powers to act in relation to taxation must also be exercised in accordance with State aid rules.

EU changes to direct taxation which may be reversed: The list includes:
Extension of tax reliefs for foreign charities
EU insistence on more closely targeted anti-avoidance rules:
Fisher (transfer of assets abroad)
Defences to s.13 TCGA (economically significant activities carried on outside the UK)

Where a dispute depends on breach of EU law, try to expedite it?

1.3 *Mutual assistance treaties*

The Brexit paper provides:

> Finally, there are a number of EU instruments relating to administrative cooperation to exchange information and help tackle tax evasion. In the latter case it seems likely that outside the EU the UK will seek to maintain some form of bilateral agreement akin to these provisions, given the growing consensus between governments that there is a very important international dimension to taxing multinational corporations fairly, and effectively tackling tax avoidance.

1.4 *Implications for drafting long term contracts*

Withholding tax may be imposed where none currently.

Assuming VAT continues to apply in the UK, or something very similar to it, it remains to be seen how it will operate between the UK and EU.

Add a Brexit caveat to all long term advice.

1.5 *Implications for wills: EU succession regulation*

EU Regulation No 650/2012 ("the Succession Regulation") applies to EU states except the UK,[2] Republic of Ireland and Denmark.
In the following discussion:
"SR states" are those where the Succession Regulation applies.
"The nationality-state" of a person is the state of which they are a national.
"**The habitual-residence state"** of a person is the state where they are habitually resident.
Although the EU Succession Regulation does not apply to the UK, it is relevant for:
(1) Individuals with property in SR states
(2) Individuals habitually resident in SR states and

2 The UK opted out of the succession regulation, mainly because forced heirship clawback would unsettle title to property; lifetime gifts to charity were a particular concern.

(3) Nationals of SR states

Under the Succession Regulation, the general rule is that the law applicable to succession of a person's estate as a whole is their habitual-residence state at the time of their death.[3] However, the person may choose the law of their nationality-state at the time of making the choice or at the time of death[4] (a **"succession-law election".)** The chosen law is then applied by SR states, whether or not it is the law of another SR (or even EU) state.[5] It applies to all succession matters.[6] The election should be made expressly in a declaration in the testator's will.[7]

A succession-law election choosing the state of nationality is particularly desirable if there may be doubts where the testator is habitually resident and it should be considered when the place of habitual residence changes.[8]

Form of declaration as to choice of law

The suggested form of declaration for a choice of English law under the Succession Regulation is as follows:

> The law of England shall govern my succession as a whole. I am a British national at the time I make this declaration.

A succession-law election should continue to be valid, even after Brexit, because its validity does not require the UK to be a member state. This will have to be reviewed.

2 Recent trust cases

2.1 *Spence v BMO Trust Co*: (Alleged) discrimination in will

[2016] ONCA 196, 18 ITELR 875

Will provided:

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3 Article 22.1. The rule is subject to exceptions: (1) Where an individual is manifestly more closely connected with another state: Art 21.2; (2) Agreements as to succession: art 25.

4 Article 22. Dual nationals may choose either state of nationality.

5 Article 20. In particular, if a UK national has land in a SR state, they may choose English law to govern the succession of their estate as a whole. English succession law will then be applied by the courts of the SR state in which the land is situate.

6 The Succession Regulation provides a non-exhaustive list of these matters, including the administration of the estate (including the powers of PRs) and entitlement to the estate (including restrictions on testamentary freedom and claims against the estate by dependents). It also includes clawback, ie obligations to restore (set aside) or account for lifetime gifts when determining entitlement to the estate such as forced heirship obligations.

7 Article 22.2. A declaration may be implied but an express declaration avoids doubt.

8 "Habitual residence" is (rightly) not defined; a little guidance is found in recitals 23 and 24 to the Succession Regulation.

'I specifically bequeath nothing to my daughter, [Verolin] as she has had no communication with me for several years and has shown no interest in me as her father.'

Daughter alleged:

> The reason my father severed the relationship with me is because I gave birth to a child fathered by a white man.'

Restatement of the importance of testamentary freedom:

> [29] I begin my analysis of the issues on appeal with consideration of the important principle of testamentary freedom.
> [30] A testator's freedom to distribute her property as she chooses is a deeply entrenched common law principle.'The freedom of an owner of property to dispose of his or her property as he or she chooses is an important social interest that has long been recognized in our society and is firmly rooted in our law.'

Other cases distinguished:

> [59] In *McCorkill*, the testator left the residue of his estate to the National Alliance, a neo-Nazi organization in the United States. ...
> the National Alliance's entire purpose was contrary to the public policy of Canada because it stood for 'anti-Semitism, eugenics, discrimination, racism and white supremacy'. The effect of the testator's gift to such an organization was to finance hate crimes, contrary to s 319 of the Criminal Code of Canada, RSC 1985, c C-46 and Canadian human rights legislation and international commitments. As a result, the application judge held, at para [89], that voiding the gift was justified on the ground of illegality, as well as public policy, because the beneficiary's 'raison d'être is contrary to public policy'.

Will did not *express* a racist motive:

> Although this may reflect the sentiments of a disgruntled or bitter father, it is not the language of racial discrimination.

But does that matter?

> [72] Eric's Will does not 'facially offend public policy'. But what if it did? Was it open to Eric to disinherit Verolin in his Will on discriminatory grounds, that is, on the express basis that the father of her son was a white man, without triggering review by the courts on the grounds of public policy?
> [73] This question lies at the very heart of Eric's exercise of his testamentary freedom. It must be remembered that the bequest at issue is of a private, rather than a public or quasi-public, nature.... Here, assuming that Eric's testamentary bequest had been facially repugnant in the sense that it disinherited Verolin for expressly stated discriminatory reasons, the bequest would nonetheless be valid as reflecting a testator's intentional, private disposition of his property—the core aspect of testamentary freedom.
> [75] Absent valid legislative provision to the contrary, the common law principle of

> testamentary freedom thus protects a testator's right to unconditionally dispose of her property and to choose her beneficiaries as she wishes, even on discriminatory grounds.

Uncertainty and slippery slope arguments:

> [101]... third-party evidence of a testator's intentions gives rise to both credibility and reliability issues. ... credibility issues arise 'because would-be beneficiaries can, without fear of contradiction by the deceased, exaggerate their relationship and fabricate the promises of bequests'. Reliability issues arise 'because testators are not obliged to write their wills to accord with the sincere or mendacious assurances they may have given to those close to them'. ...
> [102] ... Consider that would-be beneficiaries can, without opportunity for rebuttal by the testator, exaggerate or fabricate the testator's predilections or utterances and conduct during life in an effort to ground a discriminatory motive claim. Just as a would-be beneficiary cannot 'directly discern' the intentions of a testator, so too is a would-be beneficiary unequipped to 'directly discern' a testator's true motive in making a particular bequest. The law does not require a testator to explain, let alone to defend, her reasons for her testamentary dispositions.

Moral for will drafter

Relevant to UK debate on Sharia-compliant wills. Drafting Trusts & Will Trusts (Kessler and Shaw, new edition forthcoming December 2016) provides:

> Testamentary freedom conferred by English law includes freedom to make a will in accordance with the principles of Muslim (Sharia) law. ... The Law Society practice note[9] proved contentious. Leaving aside the objections from irrational islamophobes, the problem is that Sharia inheritance law, at least as commonly understood,[10] discriminates against women, illegitimate children, and non-Muslims. It is said that the Law Society failed to give due consideration to this, and were in breach of s.149 Equality Act 2010 ("A public authority must have due regard to the need to eliminate discrimination and advance equality of opportunity").[11] As far as the will drafter is concerned, they should not stereotype Muslim clients with the expectation that they will want a Sharia-compliant will, or encourage sex or other discrimination in their client's testamentary dispositions.[12] However there is little prospect of that. Testamentary dispositions are chosen by a testator, and are a matter for them; the drafter will advise on how to achieve an intended outcome, not on what that outcome should be. The drafter drafts the will on the client's instructions. Client autonomy is a fundamental value in the legal profession. There is not

9 Law Society, "Sharia succession rules" (March 2014).

10 See Encyclopaedia of Forms and Precedents vol 42(3*) Wills and Administration Specialist Topics* (2012) part 12. Perhaps alternate views are possible: see Pearl and Menski, *Muslim Family Law* (1998).

11 Opinion of Karon Monaghan QC (2014) *http://freethoughtblogs.com/maryamnamazie/files/2014/09/Law-Society-Sharia-Advice-final-August-2014.pdf.*

12 Sections 19, 29, Equality Act 2010.

much point in testamentary freedom if legal advice is not available to give effect to that freedom.

Moral for drafter

2.2 *Clayton v Clayton*: Illusory trusts

[2016] NZSC 29

A substantive trust must confer rights on more than one person. A trust with one beneficiary is:
(a) a bare trust (if the trustee is not the beneficiary) or
(b) not a trust (if the beneficiary is also the "trustee")
A trust which appears to take the form of a substantive trust, but which (on a proper construction) has only one beneficiary, is an *illusory trust*.[13]

The settlor was sole trustee of a discretionary trust and included in the class of beneficiaries. The trust provided that a trustee who is a beneficiary may exercise any trustee power in their own favour.
The New Zealand High Court found the trust was invalid as an illusory trust.
The Court of Appeal took the opposite view. It considered that the terms of the trust did not erode Mr Clayton's obligation as trustee to act honestly and in good faith; and the other beneficiaries were able to enforce that obligation. On that basis there could be no illusory trust:

> ... once a court accepts, after an examination of all the relevant evidence relating to the settlor's intentions, that a valid trust has been established and is not a sham, the trust should not be able to be treated as non-existent because the trustee has wide powers of control over the trust property.[14]

The Supreme Court was split and chose to leave the question for another day.[15]

Moral for drafter

2.3 *Re Representation of C: Z trusts I to VIII* (priority of claims of former trustees and present trustees against insolvent trust fund)

[2015] JRC 31, 18 ITELR 544
and [2015] JLR 214

Insolvent trust, with insufficient funds to meet claims by:
-former trustee (liabilities properly incurred, for which it would have been entitled to reimbursement from the trust fund had it been trustee)
-present trustee (mainly its fees)

13 See Kessler, *Taxation of Foreign Domiciliaries* (2016/17 edition) para 91.5 (Bare trust/nomineeship).

14 [2015] NZCA 30 at [80]

15 [2016] NZSC 29 at [127]. The issue was "a matter of some complexity on which the Court does not have a concluded unanimous view. In light of that, we do not intend to determine the issue because the settlement of the proceedings makes it unnecessary to do so."

-other creditors

Jersey law, but similar/same principles as English law.

Former trustee had retired, transferred funds to new trustee (the present trustee) and obtained an indemnity in a standard form:

> 4 The Retiring Trustees hereby resign from the office of trustees of the trust and the New Trustees hereby accept such resignation and the Retiring Trustees hereby acknowledge that reasonable security, inter alia in the form of the releases and indemnities herein contained, has been provided to them in respect of their trusteeship of the Trust.
> 5 Subject as hereinafter provided the New Trustees hereby covenant with the Retiring Trustees for themselves and as trustees and agents for and on behalf of each of the Indemnified Persons that the New Trustees will at all times hereafter release and indemnify and save harmless the Indemnified Persons and each of them from and against all and any actions proceedings, costs claims and demands which may be brought or made in connection with the trusts of the Trust or in any way relating thereto or to the trust funds comprised therein from time to time or the income thereof or any part thereof or any taxes duties or other fiscal liabilities whether or not now existing payable in any part of the world on or in respect of the said trust funds of the Trust or the income thereof or any part thereof respectively or in respect of any property transferred by or to or under the control of the Trustees or any persons interested under the Trust and whether or not in respect of a period or event falling wholly or partly after or prior to the date hereof and whether the same shall be enforceable in law or not it being nevertheless provided that;
> (1) …
> (2) In the event of any person (a "Transferee") becoming entitled to the transfer to him as beneficiary or as trustee or otherwise of the capital of the said trust funds or any part thereof (a "Capital Amount") the New Trustees covenant that they will not part with such Capital Amount except upon terms that such Transferee shall indemnify and save harmless the Indemnified Persons in the same terms mutatis mutandis as this clause 5 (including the provisos) save that such indemnities shall relate only to such Capital Amount
> provided further that insofar as the New Trustees shall seek to transfer a Capital Amount to a transferee after the expiration of 10 years from the date of this Deed such indemnity shall only extend to liabilities in the character of tax, duties or other fiscal claims (including interest and penalties) as specified in clause 7 herein;
> (3) The extent of the liability of the New Trustees under this clause 5 shall be limited to the said trust funds of the Trust in the possession or under the control of the New Trustees from time to time save that in the event that the New Trustees shall part with any Capital Amount without obtaining an indemnity from the Transferee as required under clause 5(2) hereof any claim under or pursuant to this clause 5 against the New Trustees shall extend also to the value of such Capital Amount.

The former trustee claimed its rights had priority over the rights of the present trustees. "It is agreed between the parties that [the Court] should determine this issue in early course".

The Court cited *Lewin on Trusts* (now, 19th ed para 17-035):

> The trustee's rights of indemnity go further than simply giving him something like a common law lien which is dependent upon the ability to exercise legal control. The rights of indemnity give him a proprietary equitable charge over, or equitable interest in the trust property, and there is no reason why this charge or interest should disappear upon the appointment of new trustees."
>
> The authors then go on to distinguish between a situation where trustees have distributed assets to beneficiaries, in which case that "should be taken as releasing any equitable rights", and a situation where new trustees are appointed, in which case there is "no reason to take the outgoing trustee as giving up his rights of indemnity merely because new trustees are appointed."

Moral for drafter of deeds of retirement/indemnities

For further discussion, see *Drafting Trusts & Will Trusts* (13th ed, forthcoming December 2016) chapter 32 (Indemnities for executors and trustees).

2.4 *Burns v Burns (The golden rule)*

[2016] EWCA Civ 37, 18 ITELR 706

Drafting Trusts & Will Trusts (Kessler and Shaw, new edition forthcoming December 2016) provides:

> In the case of an aged testator or a testator who has lately suffered a serious illness, there is one golden rule which should always be observed, however straightforward matters may appear, and however difficult or tactless it may be to suggest that precautions be taken: the making of a will by such a testator ought to be witnessed or approved by a medical practitioner who satisfies themselves of the capacity and understanding of the testator, and records and preserves their examination and findings.
>
> There are other precautions which should be taken. If the testator has made an earlier will this should be considered by the legal and medical advisers of the testator and, if appropriate, discussed with the testator. The instructions of the testator should be taken in the absence of anyone who may stand to benefit, or who may have influence over the testator.
>
> These are not counsels of perfection. If proper precautions are not taken injustice may result or be imagined, and great expense and misery may be unnecessarily caused.[16]
>
> The same applies of course to a lifetime gift or settlement made by such a client.

In Burns v Burns, the solicitor was apparently unaware of the rule! But:

> it has to be recalled, however, that the 'rule' is a prudent guide for solicitors dealing with

16 *Re Simpson* (1977) 121 Sol. Jo. 224 and often approved; see eg *Key v Key* [2010] 1 WLR 2020 at [6]. See Ch. 4 of the Mental Capacity Act Code of Practice *https://www.gov.uk/government/publications/mental-capacity-act-code-of-practice*, and The British Medical Association and the Law Society, Assessment of Mental Capacity: A Practical Guide for Doctors and Lawyers, (3rd ed., 2009).

> a will for an aged testator or one who has been seriously ill. ... the rule does not constitute a rule of law but provides guidance as to a means of avoiding disputes; 'it is not a touchstone of validity or a substitute for established tests of capacity or knowledge and approval.'

Also note ongoing Law Commission project in this area.

Moral for will drafter

2.5 *P v P [2016]:* Variation of Trusts

To be reported when judge approves the text of his judgment.

Variation of Trusts Act 1958 section 1(1):
"Where property ... is held on trusts ... the court may if it thinks fit by order approve on behalf of—
(a) any person having, directly or indirectly, an interest, whether vested or contingent, under the trusts who by reason of infancy or other incapacity is incapable of assenting, or
(b) any person (whether ascertained or not) who may become entitled, directly or indirectly, to an interest under the trusts as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, so however that this paragraph shall not include any person who would be of that description, or a member of that class, as the case may be, if the said date had fallen or the said event had happened at the date of the application to the court, or
(c) any person unborn, or
(d) [refers to discretionary objects under protective trusts]
any arrangement ... varying or revoking all or any of the trusts, or enlarging the powers of the trustees of managing or administering any of the property subject to the trusts:
Provided that except by virtue of paragraph (d) of this subsection the court shall not approve an arrangement on behalf of any person unless the carrying out thereof would be for the benefit of that person.

It is well established (in particular from *DC v AC* [2016] EWHC 477 (Ch) and *Wyndham v Egremont* [2009] EWHC 2078) that:
- The courts do in principle approve variations which extend the perpetuity period and the power to accumulate income.
- The variation of the kind proposed does not determine the existing interest in possession, or give rise to a disposal for CGT purposes.

This arrangement was to:

(a) set a new perpetuity period and accumulation period- for a further 125 years;
(b) confer additional administrative powers
(c) while preserving all existing interests in possession in the settled property, to create reversionary life interests for surviving spouses of life tenant beneficiaries;
(d) to create discretionary trusts during the remainder of the Trust Period with a wider class of beneficiaries

(e) Settled Land Act 1925 disapplied.

Moral

2.6 *R v HMRC* [2016]: Recovery of sum deducted under Swiss Tax Agreement

Deduction of £60k from individual's Swiss account under Swiss Tax Agreement. Tax liability £1k.

Can HMRC keep the windfall?

High Court has granted permission for judicial review

Moral

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