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Jersey & Guernsey Law Review – February 2007
SHORTER ARTICLES AND NOTES
TRUSTEES, TAX AND DISCLOSURE – THE HMRC DIMENSION

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1 As a result of the increasing interest shown by HM Revenue and Customs ("HMRC") in offshore tax avoidance schemes, trustees in Jersey and Guernsey will now often face requests from UK based beneficiaries for trust and company information pursuant to what are known as section 20 notices. Section 20 of the Taxes Management Act. 1970 gives HMRC the authority to require a person to deliver up documents in that person's "possession or power" for the purposes of enquiring into his/her tax affairs. In circumstances where a person has received income through an offshore structure such as, for example, an employee benefit trust and related companies, HMRC will be keen to try to use section 20 to obtain information about the structure so that it can assess whether, from a UK tax perspective, it can be said to have worked (in which case the individual will have saved tax) or failed (so that the individual falls liable to pay English tax on the income received through the structure). Beneficiaries and trustees alike have a real interest in understanding what the role of a Channel Island trustee should be in relation to a section 20 notice directed to a UK based beneficiary, not least because failure by the recipient of a section 20 notice to provide the information can result in a fine or imprisonment.

2 For an individual to be obliged to disclose information about the structure to HMRC, that information has to be within his/her "possession or power". For a document to be in a person's possession or power for the purposes of section 20, that person has to have a presently enforceable legal right to obtain inspection of it from the holder of the document without the need to obtain the consent of anyone else, or a *de facto* ability to obtain the document.[1] Can trust documents be said to be within the possession or power of the beneficiary of a Jersey or Guernsey discretionary trust? The answer seems to be no. Certainly, the beneficiary will have no *de facto* ability to obtain the information about the structure. Can he/she be said to have a presently enforceable legal right to obtain the information from the trustees? Recent case law suggests that he/she does not have such a right. Such entitlement as a beneficiary may have to see trust documents arises out of the court's inherent jurisdiction to supervise, and if necessary, to intervene in, the administration of trusts. The courts will enforce a right of access to uphold the beneficiary's entitlement to a reasonable assurance of the manifest integrity of the administration of the trust by the trustees, but a balancing exercise must be undertaken in relation to the various interests at stake, before a court can reach a decision as to whether

[1] *Meditor Capital Management Ltd v Feighan (Inspector of Taxes)* [2004] STC (SCD) 273, citing *Lonrho Ltd v Shell Petroleum* [1980] 1 WLR 627, 635.

or not a beneficiary has a right to trust documentation in any particular case.[2] As the Royal Court of Jersey has stated, "A request for disclosure must be weighed against the interests of the beneficiaries as a whole and if the trustee forms the view that disclosure of documents to which a beneficiary would normally be entitled would be prejudicial to the interests of the beneficiaries as a whole, it may refuse to seek that disclosure and seek the directions of the Court."[3]

3 When served with a section 20 notice, a beneficiary's only option is to ask the trustees to provide him/her with the information. How should a Channel Island trustee respond? The following factors should be considered by the trustee -

(a) in circumstances where it is clear that the beneficiary is seeking the information in order to give it to HMRC pursuant to a section 20 notice, it will be obvious that the information is not being sought to satisfy the beneficiary that the trustee is properly performing its duties under the trust; and so it cannot be said that the request has anything to do with the supervision and enforcement of the trust;

(b) what is more, the trustee must consider whether there are other beneficiaries of the trust whose interests it should also take into account in deciding whether or not to disclose the information about the structure (as to which, see more below). If the trustee is satisfied that the interests of HMRC are not necessarily consistent or co-extensive with the interests of all the beneficiaries of the trust, it is perfectly entitled to take this into account in deciding not to disclose the information; and

(c) there is also Jersey authority to the effect that where trust accounting documentation is sought by a beneficiary in circumstances where that information *might* be used for the purposes of challenging the validity of the trust, the trustee is under no obligation to disclose it.[4] The mere possibility of a future challenge will suffice. If the trustee is aware that HMRC is querying the integrity of the structure for tax purposes, the risk that it may be challenged by HMRC is sufficient to justify a refusal by the trustee to disclose the information sought.

4 Consideration of the above factors will often lead the trustee to conclude that the information should not be disclosed to the beneficiary and these factors will justify an initial negative response by the trustee. A prudent trustee would then be well advised to make an application to the Royal Court for directions. In the course of that hearing, unless the trustee is surrendering its discretion entirely to the Court, it will have to make submissions as to whether an order for disclosure should be made. Considerations which the trustee

[2] *Schmidt v Rosewood* [2003] UKPC 26
[3] *In Re: Rabaiotti 1989 Settlement* 2000 JLR 173, at 183, per Birt, Deputy Bailiff.
[4] *In the matter of the M Trust, Nearco Trustee Company (Jersey) Ltd v AM & Ors* [2003] JRC002A.

and the Court will need to bear in mind in reaching a view on whether disclosure is in the best interests of the beneficial class as a whole are likely to include the following -

(a) Are the interests of the beneficiary who has made the request consistent with the interests of all the other beneficiaries? If, for example, the trust is part of an employee benefit trust scheme and some beneficiaries have received section 20 notices but others have not, is it in the interests of them all that the information (which may relate to the effectiveness of the scheme as a whole) should be disclosed?

(b) Have he/she and/or other members of the beneficial class been advised from a tax and/or general legal perspective as to the relative merits of disclosure and non-disclosure? What is their position?

(c) Does the structure work from a UK tax perspective? It may be necessary to take English tax advice on this point. HMRC may use the information to attack the structure. It is important to know whether the information shows that the scheme worked or failed, so that the trustee can work out whether it is in the best interests of the beneficiary and the wider beneficial class for the information to be disclosed;

5 A trustee would be well advised to open discussions with the beneficiaries at an early stage and obtain appropriate advice, so that it can form a view and present its view to the Court. In the case of an employee benefit trust, disclosure is likely to be in the best interests of the beneficiaries if it shows that either: (a) the scheme is fully effective for tax purposes, in which case the sooner HMRC is persuaded of this the better; or (b) it has clearly failed, in which case the beneficiaries may take the view that their chances of negotiating with HMRC to reduce their ultimate liability will be better enhanced if they are open with HMRC from the outset. In such a case, if all the beneficiaries have been advised and support the application for disclosure, the trustee is likely to form the view that it is in the best interests of the beneficial class as a whole for disclosure to be made. The decision whether or not to disclose becomes much more difficult if the information does not clearly show that the scheme either succeeded or failed. In such a case, disclosure could give HMRC ammunition to attack a scheme which may in the end turn out to be defensible. In such a case, a trustee is likely to wish to argue strongly against disclosure. Thus, the importance of forming a view before reaching court cannot be underestimated.

6 Advocates advising a trustee on such an application for directions will need to think hard about how best to ensure that the beneficiaries' representatives have enough information to be able to make representations at the hearing without thereby placing the documents in the power and possession of the beneficiaries for the purposes of section 20. Although any documents served on the beneficiaries for the purposes of the hearing will be covered by litigation privilege, this may not be enough to defeat the operation of section 20. The English Court of Appeal has held that although section 20 includes an

express carve out whereby a lawyer served with a notice on behalf of his/her client may refuse to deliver up without the client's consent any document with respect to which professional privilege could be maintained, there is no underlying assumption that documents covered by professional privilege are always protected from disclosure.[5] So far as Jersey is concerned the interaction between section 20 and the law of legal professional privilege is far from clear. For these reasons, a cautious trustee would be well advised to ensure that the documents in respect of which disclosure is sought remain in Jersey until the Royal Court has been able to make a determination on whether disclosure should be made. To this end, it may be necessary to consider making an application for the directions hearing to be held in private and/or for substituted service of the documentation on the beneficiaries' Jersey advocates with an order that the documentation should not be released by them nor copies provided to any third party pending the hearing.

7 As long as the costs incurred by the trustee are neither unreasonable nor excessive, it will be entitled to a full indemnity for them out of the trust fund.[6] Disclosure without a court order is a risky step for a Jersey or Guernsey trustee to take, not least because the UK tax treatment of Channel Island structures is often complicated. Trustees must always be careful to protect the interests of their beneficial class as a whole, particularly in circumstances where the integrity of the trust structure is being challenged by HMRC.

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[5] *R v A Special Commissioner, ex parte Morgan Grenfell & Co Ltd* [2001] EWCA Civ 329.
[6] *Alhamrani v Russa Management Limited & Ors* 2006 JLR 176.

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