

Illiquid Trusts – guidance on a trustee's duties: In the Matter of the H Trust [2018]JRC171

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Introduction

In a scenario that may be familiar to many professional trustees, the trustee in this case found itself in the position of holding a single asset (a London property) but no funds with which to maintain it or with which to pay the trustee's fees. The trustee considered that the property should be sold, but not all of the beneficiaries agreed.

This decision considers the trustee's duties in such circumstances.

Facts

The trust in question was a conventional discretionary trust, the settlor of which was now deceased. The beneficiaries were the settlor's children and widow.

The trust had only one asset, held via a Jersey company, which was a property in London. The property was not rented out, but was used by the beneficiaries and their families when they visited London.

However neither the company nor the trustee had funds with which to pay for the upkeep of the property, which was now deteriorating.

The trustee was also owed a large amount in fees and expenses (£120,000), and certain of the beneficiaries also claimed that they were owed money by the trust in relation to costs they had incurred in connection with the upkeep of the property.

The trustee indicated to the beneficiaries that, in the circumstances, the property might have to be sold. However, the beneficiaries strongly disagreed among themselves as to whether this should happen. Certain of the beneficiaries had put forward proposals as to how the property might be retained, although the trustee had not considered those proposals sufficiently concrete. The widow's position was not clear, and it appeared that the trustee had not had direct contact with the widow in relation to this issue.

Ultimately, the trustee took the decision that the property should be sold. However, given the divergence of opinion among the beneficiaries and the fact that this was the sole trust asset, the trustee applied to Court for a blessing of its decision.

In doing so, the trustee acknowledged that it had not taken any tax advice by reason of the trust's illiquidity. It was asserted that the beneficiaries should each obtain their own tax advice, and that the trustee would appoint its own tax advisor in relation to ATED and CGT liabilities prior to making any distributions from the proceeds of sale.

Decision

The Court was satisfied that this was undoubtedly a momentous decision, given that the property was the sole asset of the trust. In reaching this decision, the Court also confirmed that where there is contention among beneficiaries this may well of itself turn a decision into a momentous one where it is reasonable to seek the Court's approval.

The Court then had to consider the three limbs of the well-known test to be applied by the Court in considering a blessing application:

- Was the decision formed in good faith;
- Was the decision one which a reasonable trustee properly instructed could have reached;
and
- Was the decision vitiated by any actual or potential conflict of interest.

Applying the above test, the Court did not consider it could bless the decision for the following reasons.

Conflict of interest

The Court found that it was patently obvious that the trustee had a conflict of interest: the sale of the property was the most obvious way in which the trustee would be able to recover the fees which it was owed.

The Court noted that the existence of a conflict does not of itself mean that trustees may not take a decision or that the Court will not bless such a decision – for example, where the trustees

honestly and reasonably believe that they are nevertheless able fairly and reasonably to take the decision (although it would be prudent in such circumstances to allow the decision to be scrutinised in advance by the Court).

However, where there is a conflict of interest and a trustee subsequently seeks the blessing of the Court, it is of fundamental importance that the trustee address the conflict issue and be seen to do so.

In this case, the trustee's application was completely silent about the conflict of interest and moreover there were no trustee minutes acknowledging the existence of the conflict but explaining why it was nevertheless in the best interests of the beneficiaries/trust estate that the Property be sold.

Although not necessarily fatal to the application (the decision may be so obviously appropriate that the Court should nevertheless approve it), the failure to disclose and acknowledge the conflict of interest meant that the Court would give heightened scrutiny to the decision and would likely make it more difficult for the court to be satisfied that the decision was not in fact influenced by the conflict.

In this case there were three further factors, which led the Court to question the reasonableness of the decision.

Tax consequences

The Court did not consider that the illiquidity of the trust was a proper excuse for not seeking tax advice, given that the trust had a substantial asset and that the trustee would no doubt be able to reimburse itself out of the proceeds of sale.

Beneficiaries' proposals

While the Court acknowledged that the proposals put forward by certain of the beneficiaries had not always been very specific or evidence based, it was premature to decide that there was no alternative to a sale. For example, there seemed to be a real possibility that lending might be available which would enable the property to be retained.

In this regard, the Court considered that the trustee should have been proactive in seeking to establish whether there was any alternative to a sale, but that instead it had adopted a rather passive stance and simply left the beneficiaries to see if they could reach an agreement.

Widow's position

The Court considered that the trustee should have ascertained the widow's position, if possible, prior to reaching a decision.

Comments

This case provides welcome confirmation of the principle that the Court will generally be receptive to applications for a blessing by trustees where their decisions may be contentious.

However, it also provides a salutary reminder that trustees should always be alive to the possibility of a conflict of interest, and that any conflict of interest should be carefully addressed.

The case also shows that a trustee may be expected to continue to incur costs notwithstanding that a trust is temporarily illiquid, where those costs relate to the sale of trust assets and the treatment of the proceeds. A trustee must ensure that it takes reasonable steps to ensure that its decisions are fully and properly informed, and a temporary lack of trust funds will not excuse the trustee from taking such steps.

Finally, the decision highlights that the Court will expect trustees to be proactive in such circumstances – not only in terms of liaising with beneficiaries, but also in terms of investigating the options that may be available.

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