Conyers Dill & Pearman

OFFSHORE CASES

OCTOBER 2014

CAYMAN ISLANDS

COURT OF APPEAL

***J.F. and M.F. -v- Hexagon Investment Limited, New Zealand Trust Corporation and ors (Re the Hexagon Settlement and the Hope Trust) (Unreported)* (22 October 2014)**

TRUSTS - INVESTMENT PORTFOLIO - VESTING OF TRUST ASSET - LEGAL OR BENEFICIAL OWNER - RESULTING TRUSTS - IMPACT OF STRUCTURE ON CAPITAL GAINS AND INHERITANCE TAX

The Plaintiffs moved with their children from the UK to New Zealand in 2001. They purchased a home there and brought with them certain assets. However, two substantial investment portfolios remained with Rathbone Brothers Plc and Merrill Lynch in their London offices (respectively, the "Rathbone Portfolio" and the "Merrill Portfolio").

In 2004, having lived in New Zealand for three years, the Plaintiffs and their children all acquired New Zealand citizenship. The Plaintiffs were then introduced to G.C., a New Zealand lawyer, whom they ultimately instructed to advise them in regards to the management of the family's investments. G.C. advised the Plaintiffs, in order to avoid certain New Zealand tax liabilities on their worldwide assets, they would need to 'ring-fence' those assets offshore. He suggested using an offshore vehicle into which assets neither brought into New Zealand, nor originating in New Zealand, could be placed. Hexagon Investment Limited ("HIL"), a Cayman Islands company, was subsequently formed for this purpose.

The Plaintiffs gave evidence that, from the outset, it was their understanding the Rathbone Portfolio and the Merrill Portfolio (collectively the "Portfolios") would be transferred to HIL absolutely. Also, they would retain full control over those assets as the sole Directors of HIL and they could wind up HIL at any point to recover the assets.

Shortly thereafter, the Plaintiffs became aware of the possibility of the introduction of a capital gains tax and inheritance tax regime in New Zealand, on the basis of a potential change in political parties at the time. G.C. advised setting up the Hexagon Settlement, with HIL as trustee, in order to have a structure ready in the event of future unfavourable changes to the New Zealand tax regime, so there would be a vehicle of recourse for the offshore assets.

Following G.C.'s advice in respect of HIL, the Plaintiffs instructed Rathbone Brothers Plc to assign the Rathbone Portfolio to HIL. The Plaintiffs then executed a client management agreement in respect of the Rathbone Portfolio, in their capacity as directors of HIL. At no point did the Plaintiffs believe they were transferring the Rathbone Portfolio into the Hexagon Settlement.

The same was intended to occur in respect of the Merrill Portfolio. However, this time, G.C. directly handled the transfer and instructed Merrill Lynch that the Merrill Portfolio was to be transferred to HIL, which would receive the assets acting in its capacity as trustee of the Hexagon Settlement. The Plaintiffs were unaware of the details of this correspondence.

The Plaintiffs decided to move back to the UK in 2009. However, prior to their departure they received further advice from G.C. that, from a New Zealand legal perspective, there were tax advantages to resettling the Hexagon Settlement's holding of assets unto another New Zealand trust with NZTCL, a New Zealand trustee (the second Defendant). Relying on this advice, the Plaintiffs subsequently instructed NZTCL to settle the Hope Trust, with itself as sole trustee, for the purpose of holding the Portfolios on Trust. Then, immediately following their return to

the UK, the Plaintiffs instructed Rathbone Brothers Plc to transfer "*all assets of the Hexagon Settlement*" to the Hope Trust.

However, they were later advised by their UK lawyers that because they were domiciled or deemed to be domiciled in the UK upon their return, the subsequent transfer by HIL of the Portfolios to the Hope Trust would have triggered a substantial charge to inheritance tax. The Plaintiffs insisted that, had they known of the tax effects they would never have authorised the transfer: on the basis that the Portfolios were vested in HIL beneficially, and the Plaintiffs remain the ultimate beneficial owners and directors of HIL, they would have received advice from their UK lawyers not to enter into the Hope Trust transfer.

The question for the Court was therefore whether HIL received the Portfolios: 1) as legal or as beneficial owner; 2) as trustee of the Hexagon Settlement; or 3) on resulting trust for J.H. and M.H.

The answer depended on the Court's determination of the Plaintiff's intentions at the time of making the Portfolio transfers. The Chief Justice applied the principles set out in *Vandervell -v- IRC* [1967] 2 AC 291 and *Sillett -v- Meek* (2007) 10 ITELR 617 and adopted the following approach: 1) assess whether the documentation effecting the original Portfolio transfer discloses the intentions of the Plaintiff; 2) if it does not, then consider the entirety of the extrinsic evidence as to the Plaintiff's intentions; 3) if the evidence is conclusive, then declare according to its meaning and effect; 4) if the evidence is inconclusive on the balance of probabilities, fall back upon the relevant presumption (which was in this case, a resulting trust).

The Chief Justice found, on the basis of the documents and extrinsic evidence, there was compelling evidence to suggest that the expressed intentions of the Plaintiffs was that they never wished to alienate the beneficial interests in the Portfolios, which indicated they never intended to settle the Portfolios in trust: in addition to the Plaintiffs own affidavit evidence, the Rathbone client management agreement was signed by the Plaintiffs as Directors of the account holder, HIL; documents sent to Rathbone for the purposes of opening the account in the name of HIL were the incorporation documents and not the deed of the Hexagon Settlement; the books of Rathbone record HIL as the "owner" of the Rathbone Portfolio; and, the W8-BEN forms (certificate of foreign status of beneficial owner for US withholding tax) listed HIL as beneficial owner of the Portfolios. In fact, as the Chief Justice indicated, a great deal of the confusion, giving rise to most of the issues in the case, was due to G.C.'s "*proneness to error*" and miscommunication.

Finally, a further argument was raised by Counsel for the third to sixth Defendants in respect of the Hexagon Settlement, which contained a clause that required acceptance of any assets to be added to the Settlement, specifically providing: "all money instruments and property paid or transferred to and accepted by the Trustee…as additions to the Trust Fund". Counsel argued that, regardless of the clause in the Hexagon Settlement, when the transferee is the trustee (in this case, HIL as trustee for the Hexagon Settlement), a presumption arises that the property is transferred to him as an addition to the existing trust.

However, the Chief Justice found, the presumption, derived from *In re Curteis' Trusts* (1872) L.R. 14 Eq. 217., would only apply where not precluded by the express terms of a valid settlement. The clause in the Hexagon Settlement indicated a pre-condition for acceptance by the trustee of the assets being transferred, requiring a positive action on the part of the trustee, which had not occurred. The Chief Justice recognised that such clauses were commonplace and were included for good reason: it prevents a trustee from being saddled with burdensome assets that could give rise to considerable liabilities for the trust, only to have to go to the trouble of disclaiming them.

In the circumstances, the Chief Justice concluded the Portfolios never became vested in HIL as trustee of the Hexagon Settlement, but instead as absolute owner. It therefore followed that, the purported transfer of the Portfolios from the Hexagon Settlement to the Hope Trust, on the Plaintiffs return to the UK, was ineffective, as there were no such assets to be transferred.

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