

Does charity start with the taxman?

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Representation of IQEQ (Jersey) Limited re the May Trust Royal Court of Jersey; Bailhache, Commissioner and Jurats Ramsden and Averty, 14 May 2021

The Royal Court has approved the distribution of almost half of the substantial trust fund of a family trust to the principal beneficiary, to allow him to donate it to charity.

The Court's judgment is significant not only for the extent of the distribution that the Court permitted, but also in that the beneficiary proposed to incur deliberately a tax liability on the donation that could otherwise have been legitimately avoided. In deciding the application, the Court made observations that will be significant for families and trustees who wish to support charitable and socially responsible objectives with trust assets, especially in cases (unlike the present) where the trust does not include charitable objects.

Facts

By the time the application came to be heard, the beneficiaries of the trust were the principal beneficiary, his wife, his three daughters and four grandchildren, their issue, and a charitable foundation (the "Foundation") established by the principal beneficiary and administered by him, his wife and an independent trustee.

The trust had a history of charitable donations, with sums in excess of £8 million having been paid to charity by the time of the application while not more than £100,000 had been paid to the family. It was now proposed to distribute £75 million (almost half the trust fund) to the principal beneficiary for him to transfer to the Foundation. Although the trustee could have

distributed this amount directly to the Foundation without incurring liability to tax, the principal beneficiary sought the distribution to himself as a UK taxpayer so that he could make transfers to the Foundation in such a manner (by electing and not electing gift aid relief on different tranches of the sum transferred) that an effective tax rate of 25% would be incurred on the total sum transferred. The family believed that the payment of tax would enable the government to provide a broader social benefit.

The trust contained a power to apply capital in the following terms:

"... the Trustees shall have power in their absolute and unfettered discretion to pay or apply the whole or any part of the capital of the Trust Fund to or for the benefit of such one or more of the beneficiaries for the time being living in such shares if more than one and in such manner as the Trustees shall in their absolute discretion think fit."

The Court observed that it was unusual for it to be asked to approve an arrangement which has the purpose of paying tax in the United Kingdom. However, the main question the Court had to determine was whether the proposed distribution was for the principal beneficiary's benefit, he being the beneficiary in whose favour the power was being exercised.

Whether a distribution is for a beneficiary's benefit

The Court accepted that "benefit" to a beneficiary is not limited to financial benefit, it is to be widely construed, and includes educational and social benefit. That approach to assessing benefit to a beneficiary is the same whether the Court is considering whether to approve a proposed exercise of a

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trustee's power or an application for approval by the Court of a proposed variation of a trust on behalf of minor and unborn beneficiaries.

The Court considered that an appointment to the principal beneficiary with the intention that he transfer it to the Foundation could not amount to a fraud on a power, given that the Foundation was itself an object of the Trustee's power. However, even if that were not the case, *Clore's* case (an English case from 1966) showed that a distribution to allow a beneficiary to make a gift to charity is for his benefit if it allows them to discharge a natural or moral obligation to provide for charity that the beneficiary themselves recognises to exist¹. If the beneficiary considers they are under such an obligation, the trustee providing the funds to discharge it improves the material situation of the beneficiary as they do not have to discharge the obligation from their own resources. In *Clore's* case, the amount advanced on the beneficiary's behalf was 1/7th of the trust fund, which the Court in that case considered was of an appropriate proportion and not excessive.

The quantum that trustees can properly apply to charity to discharge a beneficiary's acknowledged moral obligation was considered in the English case, *X v A*². The proposed distribution in that case was the significant majority of the trust fund and exceeded the beneficiary's own ability to give to charity from her own assets. The Court in that case considered that the proposed distribution could not be considered to improve her material situation, as she could not objectively be considered to have a moral obligation to benefit charity to an extent that exceeded her own personal means³.

It was submitted that *X v A* should not be followed in Jersey given the differing context of modern offshore trusts. In particular, it was argued that settlors frequently place in offshore trusts a substantial proportion of the family assets, whether for asset protection reasons, the defence of inheritance claims, tax protection or privacy. None of those objectives was inconsistent with the recognition of a moral obligation to give to charity from those assets and Jersey law ought not to put up obstacles to such giving.

The Court accepted these submissions. It considered that *X v A* was very much influenced by its particular facts. It also accepted that offshore trust arrangements are characterised by their flexibility to meet the needs of the families whose wealth is settled in them. In that context, the question of whether a proposed appointment is for the benefit of a beneficiary cannot be answered by assessing whether or not the beneficiary could discharge the moral obligation themselves from their own assets. Instead it is necessary to consider the benefit that would arise from the exercise of the power and whether the beneficiary recognises the moral obligation that the trustee intends to allow him to discharge.

Outcome of the case

On the facts, the Court was satisfied that the trustee could reasonably decide that the proposed distribution was for the benefit of the principal beneficiary. It enabled him and his wife to continue their philanthropic work through the Foundation which was itself a beneficiary of the trust. The arrangements which he intended to make in relation to payment of tax did not detract from the purpose of making the payment which was to allow him to benefit the Foundation. Equally, however, the Court accepted that the decision not to claim tax relief in respect of some of the money to be paid to the Foundation also fits the social justice aspirations of the family.

The Court was also willing to approve the proposed amount of the distribution, notwithstanding that further charitable giving was anticipated which would leave £50 million in the trust. Having regard to the family ethos in favour of charitable giving and the other resources likely to be available to the family members, the Court considered that the amount of the proposed distribution was not unreasonable.

Comment

The recognition that discharge of a beneficiary's perceived natural or moral obligation can be to their benefit even if the beneficiary could not discharge that obligation themselves from their own assets is to be welcomed.

For the Royal Court to have followed the existing English authority would have been to impose an arbitrary restriction on the powers of trustees and potentially inhibited beneficiaries from being open with their trustee as to the purpose of seeking a distribution. At a time when much of the world's wealth is concentrated among a very small proportion of the global population, that wealthy individuals are willing to recognise and perform a moral obligation to apply substantial proportions of the wealth available to them for the benefit of society as a whole should be welcomed and facilitated. While not all will share the same perspective, the Court has accepted that for some families, charity can start with giving to the taxman!

Andreas Kistler acted as the guardian ad litem for minor and unborn beneficiaries in this case.

¹ *Re Clore's Settlement Trusts* [1966] 1 WLR 955.

² [2006] 1 WLR 741.

³ Applying *Re Hampden's Settlement Trusts* [2001] WTLR 195 (a case decided in 1977).

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FIND US

Carey Olsen Jersey LLP
47 Esplanade
St Helier
Jersey JE1 0BD
Channel Islands

T +44 (0)1534 888900

E jerseyco@careyolsen.com



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Visit our trusts and private wealth team at [careyolsen.com](https://www.careyolsen.com)



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