CHANCERY BAR

Prest and Beyond – Part 1 and Part 2 (Companies)

1. The circumstances in which property held by a company can be attributed to those who control it gained considerable publicity in Prest v Petrodel Resources Ltd & Others [2013] UKSC 34.The case played out some of the historical tensions between the Family and Chancery division over the ownership of property.

Part I – Prest

2. Central to Prest was the extent to which property held by a company controlled by a party to the marriage could be found to be property which the court in matrimonial proceedings was entitled to deal pursuant to S24 Matrimonial Causes Act 1973. In brief (for those unfamiliar with the case) seven investment properties were held by 'the company' as part of a legitimate tax avoidance scheme outside the jurisdiction. W claimed that the properties were H's and the court at first instance made orders against the company's property assets.

i) S24 Matrimonial Causes Act 1973

3. For the benefit of the Chancery lawyer pursuant to S24(1)(a)MCA 1973 the court has power to make an order that ***a party to the marriage shall transfer to the other party****, to any child of the family or to such person as may be specified in the order for the benefit of such a child* ***such property as may be so specified, being property to which the first-mentioned party is entitled, either in possession or reversion***

4. It must follow that company property can only be such an asset (and therefore fall to be included in S24 (1) (a) MCA 1973) if it is property to which he or she is entitled to either in

possession or reversion. By way of background until Prest it had been the practice in the Family Division to treat the assets of companies substantially owned by one party to a marriage (typically a one man company) as being available for distribution under this section provided that the remaining assets of the company were sufficient to satisfy creditors.

5. This approach was described by Patten LJ in the Court of Appeal in Prest as "*an approach to company owned assets in ancillary relief applications which amounts almost to a separate system of legal rules unaffected by the relevant principles of English property and company law" [161].*

6. Criticism of the approach was continued by Lord Sumption in the Supreme Court *'it impossible to say that a special and wider principle applies in matrimonial proceedings by virtue of section 24(1) (a)"* [37]. And finally '*Courts exercising family jurisdiction do not occupy a desert island in which general legal concepts are suspended or mean something different. If a right of property exists, it exists in every division of the High Court and in every jurisdiction of the county courts'.*

7. Prest closes the door on the practice within the Family Division whereby a one-man company had often been allowed to 'metamorphose into the one man' simply because the person wanting to extract its assets was his wife.

ii) The Legal Fiction

8. Such a 'metamorphosis' perhaps had its roots in the 'legal fiction' of the separate personality and property of a company. While concurring that it was in fact a fiction Lord Sumption was careful to point out that

"..the fiction is the whole foundation of English company and insolvency law. As Robert Goff LJ once observed, in this domain "we are concerned not with economics but with law. The distinction between the two is, in law, fundamental" [8]

9. In Prest at first instance Moylan J had proceeded on the basis of a 'power equals property' analysis. The incorrect proposition being that the controller of a company who has a right and ability to transfer assets to himself for his own use must be entitled to possession of the assets.

10. The appellant courts not only quashed this approach but also the notion that it would be acceptable (as had been said in ancillary relief claims) provided that the court could allow for 'known creditors'. Lord Sumption rightly identifies that for that to be right the family court would have to conduct a notional liquidation and wide publicity to establish what a trading company's liabilities were.

iii) No Change to the Corporate Veil

11. Prest did not change the circumstances in which the veil could be pierced; what it did was arguably reprimand the family division for lifting the veil in cases where it had considered it was 'necessary to do so in the interests of justice'.

12. The idea of lifting the veil when it was 'necessary to do so in the interests of justice' was substantially canvassed in *Trustor AB v Smallbone (No 2)* [2001] 3 All ER 987. In Trustor it was submitted that the authorities justified piercing the corporate veil in three, possibly overlapping, cases: (i) where the company was a "facade or sham"; (ii) where the company was involved in some form of impropriety; and (iii) where it was necessary to do so in the interests of justice. In each of these cases, the right of the court to pierce the corporate veil was said to be subject to there being no third party interests engaged, such as unconnected minority shareholders or creditors.

13. Trustor supported cases (i) and (ii) and in case (ii) had made clear that the impropriety had to be a relevant one, i.e. "linked to the use of the company structure to avoid or conceal liability for that impropriety" but ground (iii) was wholly rejected. The position post Trustor was and continues to be that the court was "*entitled to 'pierce the corporate veil' and recognise the receipt of the company as that of the individual(s) in control of it if the*

company was used as a device or facade to conceal the true facts, thereby avoiding or concealing any liability of those individual(s)":

14. Despite the ruling in Trustor the 'interests of justice' argument continued to be pursued in the Family Division. By way of example:

    Mubarak v Mubarak [2001] 1 FLR 673, 682C, Bodey J held that for the purpose of claims to ancillary financial relief the Family Division would lift the corporate veil not only where the company was a sham but "*when it is just and necessary";*

    Kremen v Agrest (No 2) [2010] EWHC 3091 (Fam), Mostyn J held that there was a *"strong practical reason why the cloak should be penetrable even absent a finding of wrongdoing".*

15. It is of note that the idea that the veil should still be penetrated for 'strong practical reasons' was pursued not just in the light of Trustor but also despite the judgment of Munby J actually in the Family Division in Faiza Ben Hashem v Shayif and Another [2008] EWHC 2380 (Fam).

Munby J's six principles were considered and upheld by both the Court of Appeal and Supreme Court in both Prest and VTB Capital Plc v Nutritek International Corp [2013] UKSC 5:

> *First, ownership and control of a company are not themselves sufficient to justify piercing the veil.*
>
> *Second, the court cannot pierce the veil, even when no unconnected third party is involved, merely because it is perceived that to do so is necessary in the interests of justice.*
>
> *Third, the corporate veil can only be pierced when there is some impropriety.*
>
> *Fourth, the company's involvement in an impropriety will not by itself justify a piercing of its veil: the impropriety 'must be linked to use of the company structure to avoid or conceal liability' (a principle derived from Trustor).*
>
> *Fifth, it follows that if the court is to pierce the veil, it is necessary to show both*

control of the company by the wrongdoer and impropriety in the sense of a misuse of the company as a device or façade to conceal wrongdoing.

Sixth, a company can be a façade for such purposes even though not incorporated with deceptive intent: '164 . . . The question is whether it is being used as a façade at the time of the relevant transaction(s). And the court will pierce the veil only so far as is necessary to provide a remedy for the particular wrong which those controlling the company have done. In other words, the fact that the court pierces the veil for one purpose does not mean that it will necessarily be pierced for all purposes.'

16. The strict limitations as to the only factual circumstances in which it will be open to the court to pierce the veil were affirmed. VTB illustrated that what is required to pierce is nothing less than proof of impropriety directed at the misuse of the corporate structure for the purpose of concealing wrongdoing.

17. In fact in Prest Moylan J's findings at first instance were such that the corporate veil could not be pierced. He found as a fact that the company structure was set up and used for conventional reasons 'including wealth protection and the avoidance of tax'. In doing so the finding can only have ever been that the 'wealth' of the companies (its assets) therefore belonged beneficially to the companies. In view of these findings the corporate veil could not have been pierced which was confirmed by the Supreme Court.

18. The problem was created in Prest because Moylan J went on to attribute the company's property to H pursuing the flawed 'power equals property' reasoning. Having concluded that H was in fact the sole beneficiary of the shares, in complete control of the companies and their respective wealth and the finding that the company was set up for conventional reasons, it is difficult to see how that property could have on the facts have been 'wealth' which belonged to H and not the company.

Part II – the consequences post Prest for assets held by i) a company and ii) a trust and how they can be protected (ERQC to consider assets held by a trust)

a) The concealment Principle

19. The law can attribute the acts or property of a company to those who control it but without having to disregard its separate legal personality. One obvious and important example (which was the eventual finding of the Supreme Court in Prest) is when the property belongs beneficially to the controller (H) and the finding made that the company is the trustee or nominee of the controller. Moylan J had made a finding that the company's property was 'effectively' H's property. This was plainly not enough as held by the Court or Appeal (Rimer LJ at [81]) and the Supreme Court. If there is a legal relationship between the company and its controller then it will be unnecessary to pierce the veil.

20. This is really an example of what Lord Sumption described as the 'concealment principle'. It is legally banal and is simply the interposition of a company to conceal the identity of the real actors. The court can simply look behind the façade it does not need to disregard it, there being a legitimate legal relationship between the company and controller.

b) Looking behind the façade and finding subsisting trusts

21. In Prest the Supreme Court was arguably able to 'save' the position for W by finding seven resulting trusts existed. The company held the beneficial interest in seven investment properties on resulting trust for H. (It is of note that at first instance Moylan J had already found that the FMH was held by the company on trust for H but he had not (although expressly invited to find) found that the remaining properties were held on the same basis).

Facts and Findings:

- Three of the seven properties were acquired by the company for nominal consideration of £1. In circumstances where there was no explanation for the gratuitous transfer it was held that there was

nothing to rebut the presumption in equity that the Company did not intend to acquire a beneficial interest in the same and H was the beneficial owner on a resulting trust.

- Two of the properties were acquired by the company from H for substantial consideration. There was however no evidence that he provided the money to the company by way of loan or capital subscription thus the Supreme Court concluded that H was the beneficial owner of these properties too.

- The remaining two properties were acquired in the name of the company for substantial consideration. One of the properties was purchased at a time before the company was actively trading. The court found that the funds had therefore been provided by H. The second property was purchased after trading had commenced and it could have been funded by the company itself. There was no evidence and the inference was drawn that H had not broken from past practice and it was H not the company who had provided the funds.

c) The power of adverse inferences

22. It is important for non- family lawyers when representing companies whose assets are potentially vulnerable to claims within Financial Proceedings to appreciate the use which a family court will make of adverse inferences in its inquisitorial role. The Supreme Court reminded itself in Prest of the substantial inquisitorial element which exists within Financial Proceedings. The burden of proof does not apply in the same way as Civil Proceedings. The Supreme Court affirmed that judges exercising family jurisdiction are entitled to draw on their experience and to take notice of inherent probabilities when deciding what an uncommunicative H is likely to be concealing [45].

23. It is important that the Supreme Court was assisted greatly in being able to find these resulting trusts by the silence and non disclosure by the directors of the company. The evidence at first instance had been incomplete and materially defective. For example neither H nor the companies had complied with orders for conveyancing files or completion statements. The companies' refusal to cooperate was deliberate.

24. Sach's J's exegesis of adverse inferences which can be drawn in cases of non- disclosure in J-PC v J-AF [1955] P215 was endorsed by Lord Sumption in Prest.

"In cases of this kind, where the duty of disclosure comes to lie upon the husband; where a husband has, and his wife has not, detailed knowledge of his complex affairs; where a husband is fully capable of explaining, and has the opportunity to explain, those affairs; and where he seeks to minimise the wife's claim; that husband can hardly complain if, when he leaves gaps in the court's knowledge, the court does not draw inferences in his favour. On the contrary, when he leaves a gap in such a state that two alternative inferences may be drawn, the court will normally draw the less favourable inference – especially where it seems likely that his able legal advisers would have hastened to put forward affirmatively any facts, had they existed, establishing the more favourable alternative.

Sachs J continued at p 229:

.. it is as well to state expressly something which underlies the procedure by which husbands are required in such proceedings to disclose their means to the court. Whether that disclosure is by affidavit of facts, by affidavit of documents or by evidence on oath (not least when that evidence is led by those representing the husband) the obligation of the husband is to be full, frank and clear in that disclosure. Any shortcomings of the husband from the requisite standard can and normally should be visited at least by the court drawing inferences against the husband on matters the subject of the shortcomings – in so far as such inferences can properly be drawn.

25. Lord Sumption went on to consider the proper approach to adverse inferences at [44]:

"*There must be a reasonable basis for some hypothesis in the evidence or the inherent probabilities, before a court can draw useful inferences from a party's failure to rebut it. For my part I would adopt, with a modification which I shall come to, the more balance view expressed by Lord Lowry with the support of the rest of the committee in R v Inland Revenue Commissioners, ex p TC Coombs & Co [1991] 2AC 283,300*

> *"In our legal system generally, the silence of one party in face of the other party's evidence may convert that evidence into proof in relation to matters which are, or are likely to be, within the knowledge of the silent party and about which that party could be expected to give evidence. Thus, depending on the circumstances, a prima facie case may become a strong or even an overwhelming case. But, if the silent party's failure to give evidence (or to give the necessary evidence) can be credibly explained, even if not entirely justified, the effect of his silence in favour of the other party may be either reduced or nullified. CF.Wisniewski v Central Manchester Health Authority"*:

26. Importantly he then went on to set out what he referred to as 'modifications' in relation to the drawing of adverse inferences in matrimonial proceedings saying at [45]

"The modification to which I have referred concerns the drawing of adverse inferences in claims for ancillary financial relief in matrimonial proceedings, which have some important distinctive features. There is a public interest in the proper maintenance of the wife by her former husband, especially (but not only) where the interests of the children are engaged. Partly for that reason, the proceedings although in form adversarial have a substantial inquisitorial element. The family finances will commonly have been the responsibility of the husband, so that although technically a claimant, the wife is in reality dependent on the disclosure and evidence of the husband to ascertain the extent of her proper claim. The concept of the burden of proof, which has always been one of the main factors inhibiting the drawing of adverse inferences from the absence of evidence or disclosure, cannot be applied in the same way to proceedings of this kind as it is in ordinary civil litigation. These considerations are not a licence to engage in pure speculation. But judges exercising family jurisdiction are entitled to draw on their experience and to take notice of the inherent

probabilities when deciding what an uncommunicative husband is likely to be concealing. I refer to the husband because the husband is usually the economically dominant party, but of course the same applies to the economically dominant spouse whoever it is."

27. It is also of note that use of adverse inferences in the case of defective disclosure has been expressly preferred in the Family Division as an alternative to resorting to the disapproved Hildebrand practice post Imerman v Tchenquiz [2011] Fam 116. In both Prest and (post Prest) in M v M [2013] EWHC 2534 (Fam), the court was greatly assisted in finding a resulting trust by the silence and non-disclosure of the directors of the companies.

28. M v M is a good example of the 'renewed' willingness of the family court to draw powerful adverse inferences post Prest from a director's failure to make proper disclosure, attend court or give evidence.

d) Advising the Company

29. The companies position will often be as it was in both Prest and M v M that the properties held by it outside the jurisdiction are held as part of a legitimate tax avoidance scheme. It is of note that in Prest the ultimate finding was that the properties were in fact held as part of a tax avoidance scheme however notwithstanding that finding the presumption was not rebutted. In contrast in M v M tax motivation was rejected and wholly substituted with a damning finding that H had put his assets offshore and expressly beyond the reach of W.

30. The company of course bears the evidential burden of rebutting the presumption of resulting trust. The company must prove that (H) intended the company to take the property as beneficial owner. Direct evidence of the transaction is needed. The acts and declarations of the parties before or at the time of the purchase being particularly relevant. Subsequent conduct being admissible with the court being free to assess its probative

weight[1]. Inspection orders are equally valid in the Family Division and a conveyance file will be called for. In M v M the companies called a partner, an assistant solicitor and a wealth planning assistant solicitor who had all acted for the companies during the various conveyances to give evidence. Ironically Mrs. Justice King concluded that in fact H's interaction with his solicitors pointed "towards and not away" from' H retaining the beneficial ownership [163].

31. If the evidence is incomplete or obscure then a good deal will depend upon 'what *presumptions may properly be made against H given that the defective character of the material is almost entirely due to his persistent obstructions and mendacity*'.

32. It is obvious that to discharge this burden the directors at the time the property was purchased, will be in the best position to give evidence. It is therefore in the company's interest for the director to attend for cross examination; to have a good paper trail and to give full disclosure. Great importance was attached in M v M to the fact that the directors were as elusive as H and the fact that neither had filed a statement nor attending court to give evidence and be cross examined. Mrs. Justice King wryly making comment that the only person missing from leading counsel's entourage 'was a human client'.

33. If the directors choose silence and non-disclosure then they may unwittingly (as seen in both Prest and M v M) convert a 'prima facie powerful case into a prima facie overwhelming case'. In M v M the companies simply ignored orders for specific disclosure and responded in reply to short questionnaires in the unhelpful but (in my experience) not unusual way of: *"X was not a director of the company at the time of purchase and is therefore unable to assist'*.

[1] United Overseas Bank Ltd v Giok [2012] SGHC 56. It of note that this point was canvassed in M v M drawing on Shepherd v Cartwright [1955] AC 431 but that this was rejected and particularly in the context of matrimonial proceedings and the duty under the Matrimonial Causes Act 1973 *to consider all the circumstances of the case and to achieve a fair result*

34. The company should be advised that taking and retaining notes of advice which it obtained in relation to tax, and the legal and beneficial interests in the property may become very important. The company should have a proper paper trail with board minutes and resolutions recording the decisions and the history of the property transfer or purchase. If the purpose behind the transfer or purchase has been contemporaneously recorded then it is likely to be strong evidence. If for example the purchase monies were provided in the character of an investment this should be minuted.

35. Possible clues as to intention which the court will look for are, for example, letters of engagement; if a party was acting as a designated member; questionnaires completed by the company which may reveal personal information for example (H's) email address; a password being linked to one of (H's) personal details etc. If there is doubt about whether H is the controlling mind, records held for the company can contain evidence of H giving instructions to accountants/banks/solicitors etc.

36. The company should be warned if it is intended that the matrimonial home will either be transferred to it or purchased by it, that it will have significant difficulty post Prest in providing evidence to rebut the presumption of resulting trust. *'the facts are quite likely to justify the inference that the property was held on trust for a spouse who owned and controlled the company'. In many perhaps most cases the occupation of the company's property as the matrimonial home of its controller will not be easily justified in the company's interest especially if it is gratuitous. The intention will normally be that the spouse in control of the company intends to retain a degree of control over the matrimonial home which is not consistent with the company's beneficial ownership'.* [51]

37. In light of the same the company will (in my view), have to at the very least charge rent to (H) to even start to justify the position that it is the beneficial owner of the matrimonial home.

Summary

38. In summary the finding per se, that a property is held outside the jurisdiction as part of a legitimate tax avoidance scheme is not in itself sufficient to rebut the presumption of resulting trust. The non-family lawyer must be alive to and advise companies whose assets may become vulnerable to the inquisitorial powers of the family court of:

38.1 the readiness with which the family courts will draw adverse inferences; and

38.2 The sort of evidence which the company will need to rebut the presumption of resulting trust.

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