We are indebted to our peer reviewers, who must remain anonymous.
Foreword to the First Volume

by Lord Hope of Craighead

I offer my warmest congratulations to those whose idea it was to institute the Edinburgh Student Law Review and to everyone who has been responsible for bringing this issue forward to publication. It is the first student-produced law review in Scotland and only the third in the United Kingdom. It is fitting that the Law School at Edinburgh—a city that was in the forefront of publishing political reviews in the age of enlightenment—should lead the way here north of the border.

Ground-breaking though its publication may be in this jurisdiction, the Review follows a tradition that has long been established among the leading law schools in the United States. The editorship of student law reviews in that country is much sought after, as is the privilege of having a paper accepted by them for publication. The stronger the competition for these positions, the higher the standard that is exhibited by those who occupy them. It is well known that their editors are singled out by the Justices of the US Supreme Court and the Federal Appeals Courts when they are recruiting their law clerks. The reflected glory that this produces enhances in its turn the reputation of the reviews. A reference to editorship of this Review will not escape notice if it appears on the CV of someone who is applying to be a judicial assistant to the UK Supreme Court. But participation in its publication will be of benefit in so many other ways too.

This is pre-eminently a publication by and for students. Its aim is to enhance standards of thinking and writing about law and to promote discussion among all those who are studying law, at whatever level this may be. Law is pre-eminent among the professional disciplines in its use of words to convey ideas. Thinking and writing about law is an essential part of legal training. So too is the communication of ideas about law, as each generation has its part to play in the way our law should develop for the future. I wish all success to those who will contribute to this project, whether as writers or as editors, and I look forward to the benefits that will flow from making their contributions available through this publication to the wider legal community.

David Hope
March 2009
EDITORIAL

The first edition of the Edinburgh Student Law Review was published in March 2009, and was only the second publication of its type in the United Kingdom. The aim was a simple one: to provide a forum for law students at Edinburgh to engage in the process of analysing and writing about legal issues outwith formal study. Moreover, this forum was to be one entirely managed and edited by students. In doing this we have always strived to include as broad a range of students as possible, and to deliver a stimulating and eclectic mix of legal topics in each issue. With the publication of the fourth and final issue of our first volume, we hope we have achieved each of these aims.

Over the last four years we have published articles on an array of legal subjects, from ancient questions of private law, like whether Scots property law should be codified, to the more exotic issue of legal pluralism in Nigeria. We have also delivered a mix of articles that will be of use to undergraduates in their studies alongside pieces that allow readers to get a flavour of an area of law not covered by mainstream study. Each issue has succeeded in drawing contributions from all levels of study, reflecting the diverse range of legal research and teaching taking place within the School of Law. This issue of the Review is no exception. The most distinctly British to date, it contains articles on commercial as well as public law, and tackles recent Scottish controversies such as the AXA pleural plaques case and Donald Trump’s divisive new golf course in Aberdeenshire.

Through the last four years the Review has benefited immensely from the support of the academic community. We would like to thank Professor Douglas Brodie, who met our initial proposal to create a student law review with support and enthusiasm. He has since been replaced as head of the School of Law by Professor Lesley McAra, to whom we are also indebted. The Review has also benefited immeasurably from the advice of Dr Andrew Steven, who joined us as Honorary Secretary in 2010. Finally, in addition to our customary acknowledgement, we must thank the many PhD students who have anonymously donated their time by thoroughly peer reviewing every article we publish. The Review and its contributors have benefited greatly from their efforts.

The Review is now a truly multimedia affair. Copies are available in every major law library in Scotland, and can be viewed by the entire world on HeinOnline. Copies of the Review have been seen in universities across the British Isles and Europe. The success of the Edinburgh Student Law Review can be seen as part of a wider trend of growth in student-run academic publications. We welcome the establishment of student law reviews across the United Kingdom, from Aberdeen to Southampton, and are proud to have been at the vanguard of this exciting new development.

Paul Tominey

March 2012
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A CRITICAL ANALYSIS OF THE ABILITY TO PAY

Scott H Gibson

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A. INTRODUCTION

Henry Simons stated that: “Tons of paper have [sic] been employed in teaching the world that taxes should be levied according to ability – perhaps for the reason that this word utterly defies definition in terms of any base upon which taxes are or ever might be levied.”\(^1\) This is incorrect. The lack of a \textit{consistent} definition of ability does not mean that it cannot be theoretically defined. The aim of this paper is to demonstrate that while the concept of ability to pay appears in many different guises, and the phrase “ability to pay” is often used without examination of the theory behind it, such theory does indeed exist. The two main theories, Utilitarianism and Egalitarianism, and their variants will be examined and critiqued. It will be argued that the flexible framework of ability to pay allows for a variety of conceptions and tax bases to be assessed. A

\(^1\) H Simons, \textit{Personal Income Taxation} (1938) 17.
Conclusion is drawn that income alone is too narrow a base for a true measure of ability and that endowment taxation is the ideal.

B. ABILITY TO PAY EXPANDED

Every tax system aims for efficiency. However, efficiency is not the only consideration. Elements of political morality and social value also affect the design of a tax system. Ability to pay is one framework within which to measure this social value or tax justice. Ability to pay is shorthand for a system under which those with greater capacity contributing a greater share than those with less capacity. It can also be applied to say that those with the same capacity should contribute the same amount. Ability to pay therefore calls for the distribution of income in line with vertical and horizontal equity. Despite often being used to justify progressive taxation, ability to pay only supports unequal taxation. It is the most common measure of vertical equity and has reached constitutional status in Spain, Germany and Italy.

There are many different and varied theories which offer justifications for taxing in accordance with ability to pay. Each of these theories has a different interpretation of what constitutes “ability.” Therefore ability to pay is specifically conceptualised in different guises. Due to its broad capacity-based nature, ability to pay can be (and is) applied to many different tax bases, including: income; wealth; consumption; and property taxation, among other taxes. Proponents of both income and consumption taxation have assumed that it is possible to be taxed according to the ability to pay; for consumption, cash flow is viewed as the measure of ability, called endowment of spending power. Ability to pay can be measured in a number of different units, be it utility, welfare, or actual monetary terms. Ability to pay is now most often taken in the context of an earnings tax or, more occasionally, a wealth tax. Income is a desirable base because it is easily measured.

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5 Murphy and Nagel, The Myth of Ownership (supra n 2) 12.
8 Schoenblum (supra n 4) at 235.
9 Utz (supra n 7) at 912.
C. JUSTIFICATIONS FOR USING ABILITY TO PAY

(1) General

Taxation according to the ability to pay is seen by many to sum up the issue of tax justice.\(^{10}\) However, the justifications for taxing in accordance with the ability to pay are not without their criticism. There are two main theoretical justifications of the ability to pay. The first comes from the view that someone with greater ability can contribute more because additional money is worth less to them.\(^{11}\) Under this Utilitarian (equal sacrifice) conception, the ultimate aim is to increase aggregate welfare. The second view is that those with greater ability can contribute more because they will still be left with “enough.”\(^{12}\) This Egalitarian view is more concerned with redistribution and the equalisation of people in society. There are a number of criticisms which can be levied against each of these conceptions of ability to pay.

(2) Utilitarianism

(a) Equal sacrifice

Utilitarianism proposes maximising the total welfare of the members of a society in designing policy.\(^{13}\) It looks at the welfare of society as a whole, and formulates policy on the basis of improving the welfare of the collective society; in practice this involves actions being right if they benefit the majority of society. The strict Utilitarian (or “equal sacrifice”) approach to ability to pay stems from the works of John Stuart Mill\(^{14}\) but also has its modern followers.\(^{15}\) Mill’s concept of equal sacrifice combines a number of ideas. These included: fairness; different taxpayers bearing uniform sacrifice; and measuring absolute loss of utility easily and objectively.\(^{16}\) To Mill, fairness lay at the heart of Utilitarianism. The idea of the greatest good to the greatest number is based in this conception of fairness, defined as indifference among individuals in the distribution of utility.\(^{17}\) To justify his conception of fairness, Mill turns the benefit principle on its head.\(^{18}\)

\(^{10}\) Ibid at 870; see also: N Kaldor, *An Expenditure Tax* (1955) 26.

\(^{11}\) Murphy and Nagel, *The Myth* (supra n 2) 24.

\(^{12}\) Ibid.

\(^{13}\) Ibid at 51.


\(^{16}\) Utz (supra n 7) at 887-888.

\(^{17}\) Ibid, at 888.

\(^{18}\) Mill, *Principles* (n 14) 805. The benefit principle is, in short, the principle that an individual should pay tax in proportion to the value of the benefit that that individual
Instead of people with less benefit simply paying less tax, he turns this to suggest that something should be done to remedy the position of the person who has less.

Richard Musgrave proposes that there are three possible conceptions of equal sacrifice: equal-absolute, equal-proportional, and equal-marginal sacrifice. The issue is then which of these should be preferred. Mill is not explicit in which concept of equal sacrifice he intended. In fact, Mill does not seem to recognise multiple definitions of equal sacrifice. There is no consensus among writers on this subject as to which conception of equal sacrifice is most suitable. There are two variables to these three conceptions of equal sacrifice. The first is the marginal utility of income and the second is the shape of the utility curves, something which is important in the relationship between equal sacrifice and progressivity. Marginal utility curves can be very diverse and when linked to different concepts of equal sacrifice can demand quite distinct rate schedules. Bearing these variables in mind, the three main conceptions will now be examined.

The first possible framing of equal sacrifice is equal-absolute sacrifice. Under this, the same amount of utility is taken from each individual, measured relative to some basic unit of utility. This does not mean that they give up the same amount in actual monetary terms. Assuming decreasing marginal utility of income, progressivity is required. However, progressive rates on this scale are not redistributive. If income increases more quickly than marginal utility declines, then regressive rates are needed. Equal-absolute sacrifice appears to be supported by Henry Sidgwick when he states: “taxation ought to be as much felt by those who bear it, in order that they must have the strongest possible motives for minimising it.” This suggests that everyone should bear the same sacrifice of utility but not necessarily that there should be redistribution or high progressivity. Although equal sacrifice is a Utilitarian concept, there are inevitable overlaps with Egalitarianism in the conceptions of equal sacrifice chosen. This is the least Egalitarian conception of equal sacrifice. Equal-absolute

receives from the state. Comparing the benefit principle and the ability to pay is useful and interesting. However, due to constraints of space this will not be attempted here.

20 *Ibid* 97-98.
21 *Ibid* 98.
23 *Ibid* 96.
24 Utz (*supra* n 7) at 892.
sacrifice is also supported by Murphy, Nagel and Marshall as the best conception of equal sacrifice.\textsuperscript{26}

The second approach to equal sacrifice is equal-proportional sacrifice. This involves taxpayers giving up the same fraction of their utility.\textsuperscript{27} This, though, is not the same as removing the same percentage of each person’s income and only works as a flat rate if the marginal utility of money is the same for everyone and is constant. Equal-proportional sacrifice is quite different from removing the same amount of utility; it is progressive if marginal utility declines more rapidly than average utility and regressive if marginal utility declines less rapidly than average utility. Equal-proportional sacrifice found support in Cohen-Stuart because it leaves the relative positions of different taxpayers in terms of total utility unchanged.\textsuperscript{28} Blum and Kalven also accepted the Utilitarian understanding of proportional sacrifice.\textsuperscript{29}

The third and final approach is equal-marginal sacrifice. This requires that each taxpayer gives up the same portion of their income to produce least aggregate sacrifice.\textsuperscript{30} The results may be the same as absolute or proportional sacrifice but are based on utility schedules rather than a separately set figure.\textsuperscript{31} Equal-marginal sacrifice involves confiscation of the amounts by which the highest incomes differ from the next highest until the required yield is achieved.\textsuperscript{32} This results in a very progressive tax system. The rate of tax climbs to 100% even if marginal utility declines at a slower rate than income increases. If the utility curve is constant, there is no greater tax on higher income and the total of utility left to A will increase relative to B and C after imposition of an equal tax. Exclusive justification for a progressive tax no longer exists.

Following on from Mill, Thomas Carver submitted that Mill had erred in his Utilitarian analysis.\textsuperscript{33} In proposing this, Carver relied heavily on marginal utility. Carver suggested that correct Utilitarian analysis was that “we should continue taxing the largest income until it was reduced to such a level that the last dollar of the remaining income was worth as much to its owner as the last dollar of the

\textsuperscript{26} Murphy & Nagel, \textit{The Myth} (supra n 2) 28; see also: A Marshall, \textit{Principles of Economics}, 8th edn (1922) 135.
\textsuperscript{27} Musgrave, \textit{Public Finance} (supra n 15) 96.
\textsuperscript{29} W J Blum and H Kalven Jr, “The Uneasy Case for Progressive Taxation” (1952) 19 UChiLRev 417.
\textsuperscript{30} Musgrave, \textit{Public Finance} (supra n 15) 96.
\textsuperscript{31} \textit{Ibid}.
\textsuperscript{32} \textit{Ibid}.
\textsuperscript{33} Schoenblum (supra n 4) at 237.
next largest income is worth to its owner, and only then should we begin to tax the latter at all”.34 This would lead to an extremely progressive tax system which, as Carver himself recognised, would be unworkable in a capitalist economy because of the disincentive to work brought about by high taxation (the substitution effect).35 Carver then retreats to a position of “moderately progressive” tax.36 This retreat, however, was about cost to the community not fairness to the individuals who would be particularly hard hit with this extremely progressive tax.37 Carver was not alone in his view that equal-marginal sacrifice was the best measure of equal sacrifice; Edgeworth also took this view.38 However, his reasons for supporting equal-marginal sacrifice were different from Carver’s reasons. While Carver supported equal-marginal sacrifice for reasons of equality, Edgeworth preferred it because it met the welfare aim of least aggregate sacrifice. Further, Carver’s analysis is incomplete as he fails to consider the possibility of another conception of “equal sacrifice” than equal-marginal sacrifice.39

As can be seen, for equal sacrifice to justify a progressive tax system, declining marginal utility of income must exist.40 An issue with Musgrave’s conceptions of equal sacrifice is whether marginal utility really does decline as income rises. Musgrave suggests, and it is submitted here that he is correct, that certainly objective marginal utility of income decreases with increasing income.41

However, marginal utility of income can be criticised from a subjective standpoint. The Utilitarian conception of marginal utility fails to take into account the characteristics of individuals. An altruistic low-income person may have a much lower marginal utility of income than a greedy high-income person may have. While it may be assumed on the basis of a fictional objective person that utility of wealth is the same, this ignores the realistic idiosyncrasies of individuals. The objective idea of marginal utility leads to the possible victimisation of the few for the benefit of the many.42 This is a considerable drawback to the equal sacrifice framing of ability to pay and the subsequent attempts to tie ability to pay to progressivity.

34 T Carver, “The Minimum Sacrifice Theory of Taxation” (1904) 19 PolSciQ 66 at 73
36 Ibid, at 79.
37 Schoenblum (supra n 4) at 238.
38 F Y Edgeworth, “The Pure Theory of Taxation”, in F Y Edgeworth, Papers Relating to Political Economy (1925) at 117
39 Schoenblum (supra n 4) at 239
40 Musgrave, Public Finance (supra n 15)102
41 Musgrave illustrates this well; see: Ibid 96-97 and Fig 5-1.
42 Utz (supra n 7) at 888.
Overall, there are three significant shortcomings of the Utilitarian conception of ability to pay. Firstly, Utilitarianism does not point to a particular common principle of equal sacrifice. As shown above, there are at least three. This makes the Utilitarian conception of ability to pay difficult to accept as credible. Secondly, even if a common measure of equal sacrifice could be found, it would need to be established what the appropriate utility curve was to establish a rate structure and this is indeterminable.\textsuperscript{43} Thirdly, is the problem of “interpersonal comparisons among potential taxpayers.”\textsuperscript{44} The idea that all taxpayers have same utility is unsupportable. A standard curve has been assumed before but usually for reasons of expediency, with no concern for fairness. Without being able to work out individual curves, Utilitarianism fails as it cannot truly measure equal sacrifice.\textsuperscript{45}

(b) \textit{Weighted welfarism}

Equal sacrifice is not the only Utilitarian conception of ability to pay. In the view of weighted (or “social”) welfarists, a significant failing of equal sacrifice as a measure of ability to pay is that it tends to be linked mostly to welfare of individuals.\textsuperscript{46} They argue that a true Utilitarian approach should focus on overall society welfare.\textsuperscript{47} This approach adopts a progressive rate structure based on a declining marginal utility curve and the Egalitarian idea that the market alone leads to an unfair distribution of resources.\textsuperscript{48} The weighted welfare approach is flawed though because it carries with it the problems of both equal sacrifice and Egalitarianism (discussed below). Progressivity here still leads to the substitution effect and possible evasion. The marginal utility curve makes a return but is still inherently burdened with the uncertainty outlined above. Furthermore, Social Welfarists assume that welfare or happiness can be quantified in monetary terms. The social welfare approach is an attempt to balance Utilitarianism with Egalitarianism. However, as shown, it seems merely to adopt the problems of those two approaches without offering solutions. As Schoenblum puts it: “the great problem for the welfarists has been to devise a grand and fair theory that escapes the limitations of Utilitarianism and crass collectivism, but still permits a progressive tax system with redistribution tending towards Egalitarianism.”\textsuperscript{49}

\begin{itemize}
  \item \textsuperscript{43} Schoenblum (\textit{supra} n 4) at 241.
  \item \textsuperscript{44} \textit{Ibid.}
  \item \textsuperscript{45} Musgrave, \textit{Public Finance} (n 15) 96.
  \item \textsuperscript{46} Schoenblum (\textit{supra} n 4) at 247.
  \item \textsuperscript{47} \textit{Ibid.}
  \item \textsuperscript{48} A Wagner, “Three Extracts on Public Finance”, in Musgrave & Peacock (eds), \textit{Classics (supra} n 28) 1 at 12-13.
  \item \textsuperscript{49} Schoenblum (\textit{supra} n 4) at 250.
\end{itemize}
(3) Liberal Egalitarianism

Liberal Egalitarianism is not concerned with overall society welfare, but with the equalising of people within that society.\(^{50}\) Egalitarianism is about seeking the best system for those worst off in society in order to bring their level of welfare (or another measure depending on the form of Egalitarianism) in line with that of everyone else. This is based on the political view that all people are equal and deserve equal rights and opportunities. Egalitarian philosophy views the market and society as inherently unfair because everyone has a different starting point. The unequal allocation of possibilities should not be allowed to lie where it falls and this requires intervention to rebalance opportunities and resources.\(^{51}\)

There are two main aims to Liberal Egalitarian philosophy. The first is that “brute luck”, i.e. the arbitrary distribution of financial wealth, skills and abilities throughout the population, should not be allowed to lie where it falls and should be redistributed to create an equal starting point for all. Markovits characterises this as people being in the role of “patients” who are acted on by the world in ways they cannot control.\(^{52}\) The second aim is that redistribution should not be made among people who have the same starting point and choices open to them and make different selections from among those choices. Markovits characterises people in the role of “agents” under this aim; that is to say they act on the world in ways for which they are responsible.\(^{53}\) Redistribution should be used to eliminate luck but not to alter the effects of choices. As Markovits observes though, the two goals of Liberal Egalitarian philosophy are logically incompatible: it is impossible to eliminate all brute luck and leave all choices in place.\(^{54}\) This is a fundamental flaw in Liberal Egalitarian philosophy.

Overlooking this criticism for the time being, the Egalitarian conception of the ability to pay would operate a very progressive tax system in order to redistribute brute luck. This contrasts with the equal sacrifice approach, outlined above, which is not necessarily progressive and may even be regressive. Egalitarians are not concerned with the method by which equality is reached and therefore it is of no concern to them that the progressivity proposed encourages a very strong substitution effect. Because of the elevation of the welfare of the worst off above all else, the Egalitarian view of equality can justify even an overall decline in the wealth and productivity of society.\(^{55}\) A further problem is that high progressivity

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\(^{50}\) Murphy and Nagel, *The Myth* (supra n 2) 54.

\(^{51}\) Ibid 55; see also: Schoenblum (supra n 4) at 249.


\(^{53}\) Ibid at 2295.

\(^{54}\) Ibid at 2299.

\(^{55}\) Schoenblum (supra n 4) at 249.
causes fraud and evasion by some of society’s most productive members.\textsuperscript{56} As stated by Sidgwick when talking about the prevention of evasion, a tax system should “avoid if possible any species of tax that is particularly disliked by the persons on whom it falls, even if the dislike seems groundless and fanciful.”\textsuperscript{57} A textbook Egalitarian approach can be rejected because of the substitution effect and evasion caused by its progressive approach.

One point on which Egalitarianism can be commended is that it does not rely on marginal utility curves.\textsuperscript{58} However, the Egalitarian approach raises questions, which it fails to answer, about what exactly constitutes inequality and what intervention should be made in order to rebalance it.\textsuperscript{59} A further problem with the Egalitarian approach is that the market is still the baseline. According to Murphy and Nagel, this defeats the whole Egalitarian approach as one cannot say that the market gives an unfair distribution if it is still the baseline for tax.\textsuperscript{60}

John Rawls offered one conception of how Liberal Egalitarian philosophy should influence the tax system. Rawls envisioned a society where those less fortunate had the opportunity to enhance their positions, without there being an excessive burden on those who are better off. Rawls argued for a mix of proportional and progressive taxes\textsuperscript{61} which would “gradually and continually correct the distribution of wealth to prevent concentrations of power detrimental to the fair value of political liberty and fair equality of opportunity.”\textsuperscript{62} Striking this balance, though, is more difficult in practice than in theory.\textsuperscript{63} There are also deeper issues to Rawls theory. As Schoenblum notes; Rawls conception of justice is “founded on mediocrity. It presumes that in the real world those earning less are inevitably victims of an unjust societal structure. In truth, the extent of injustice in society is unclear; so is how that injustice correlates to income earning.”\textsuperscript{64} Rawls ignores the possibility that an individual earns a high income because of hard work or some other individual trait.\textsuperscript{65}

Overall, as a justification for using the ability to pay, Liberal Egalitarianism has a number of flaws. Firstly, there is the incompatibility of the aims to eliminate

\textsuperscript{56} P Leroy-Beaulieu, “On Taxation in General”, in Musgrave & Peacock (eds), Classics (n 28) 152 at 162.
\textsuperscript{57} Sidgwick, Principles (supra n 25) 563.
\textsuperscript{58} Schoenblum (supra n 4) at 249.
\textsuperscript{59} Murphy & Nagel, The Myth (supra n 2) 55.
\textsuperscript{60} Ibid 30.
\textsuperscript{61} See: Schoenblum (supra n 4) at 251-252.
\textsuperscript{63} Schoenblum (supra n 4) at 251.
\textsuperscript{64} Ibid at 253.
\textsuperscript{65} Ibid.
brute luck and yet leave choices in place. Secondly, the progressive system demanded by Egalitarianism would lead to a strong substitution effect and encourage evasion which could be economically damaging. Thirdly, it is unclear what constitutes inequality and the measures which should be taken in order to remove it. Most fundamentally, though, the market distribution which Liberal Egalitarianism purports to reject becomes the inevitable base of taxation.

D. ENDOWMENT

(1) A better measure?

Beyond Utilitarianism and Liberal Egalitarianism, there is a further possible conception of ability to pay. This approach calls for ability to be assessed neither by someone’s welfare level, nor by their actual economic situation. Instead this measures ability to earn, assessed as the choices a person could make and the possibly higher income and wealth they would have if they utilised this potential.66 On this conception of ability to pay, the tax base is not income, as adopted by the theories above, but endowment. Endowment is a tax on human capital. As emphasised by its proponents, an endowment tax is a theoretical concept.67 There are no taxes on earnings capacity currently in existence anywhere in the world.68 Ideas similar to endowment taxation have never been far from the ability to pay.69 Originally, ability to pay was a broad concept where ability was conceived of as “faculty” which included the totality of wealth (and later productive capacity) available to an individual.70 An example often cited is of the early-American taxes which were levied according to profession.71 However, these were still distinct from an endowment tax as they focused on actual income and profession rather than the potential income or wage rate preferred by endowment tax.72 A similar approach to that of the faculty theory was adopted by Seligman who developed Mill’s general equal sacrifice theory, declaring that income tax alone is not enough to satisfy ability to pay and that

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66 Murphy & Nagel, The Myth (supra n 2) 20.
69 Walker, writing in 1888, viewed a faculty (endowment) tax “as furnishing the line from which to measure all departures from the equities of contribution, as one or another form of taxation…comes to be adopted for meeting the needs and wants of government”; see: F A Walker, “The Bases of Taxation” (1888) 3 PolSciQ 1 at 14.
70 Schoenblum (supra n 4) at 235.
71 Stark (supra n 67) at 50.
72 Ibid.
A Critical Analysis of the Ability to Pay

there was a need to combine this with property and other taxes because of differences in social demands.\textsuperscript{73}

Bradford submits that justice in taxation demands that “[i]f taxes are to be levied in accordance with means...it would be appropriate for the [taxpayer] with the better opportunities to bear the heavier burden.”\textsuperscript{74} The problem though is that these opportunities need to be quantified by some tangible measure. It is this need for easy quantification which leads to the taxation of earnings and other imperfect, but easily quantified, measures of opportunities.\textsuperscript{75} For example, ability to pay is most often assessed on an income base because of the ease of quantifying it.\textsuperscript{76} However, there are no reasons of distributive justice for preferring traditional tax bases and why “we want to redistribute [income] remains unclear.”\textsuperscript{77} As Shaviro states, the absence of a rationale for taxing on traditional bases is representative of a desire to tax a more perfect “underlying measure of inequality,” such as “endowment,” “ability” or “wage rate.”\textsuperscript{78}

Shaviro focuses on the role of inequality in the choice of a tax base. He takes the economists’ view that increased opportunities are generally advantageous.\textsuperscript{79} Furthermore, two people who are presented with the same choices and make different selections can be equally well off.\textsuperscript{80} This is based in a sound assumption that people generally have the best information about their own preferences and it would be wrong to assume that anyone has erred in making a particular choice, i.e. leisure over work. An opportunity based measure such as endowment is preferable because the traditional tax bases (i.e. income, consumption, wealth), although more easily measured,\textsuperscript{81} are affected by differences in taste and effort and treat the decision not to work as making one worse off, even though this is not always the case.\textsuperscript{82} Bradford gives three examples demonstrating this with relevance to traditional tax bases, particularly earnings.\textsuperscript{83} Shaviro submits that without outside information, particularly in terms of welfare, fiscal choices are

\textsuperscript{73} E R A Seligman, The Income Tax (1911) 16-17.
\textsuperscript{74} D Bradford, Untangling the Income Tax (1986) 154.
\textsuperscript{75} Ibid 155.
\textsuperscript{76} Schoenblum (supra n 4) at 235, see also: Seligman (n 8) at 206.
\textsuperscript{77} D N Shaviro, “Endowment and Inequality”, in J J Thorndike and D J Ventry Jr. (eds), Tax Justice: The Ongoing Debate (2002) 123 at 123 (emphasis in original); a point also adopted by Stark (supra n 67) at 51.
\textsuperscript{78} Shaviro ibid at 125; wage rate as a better measure is also supported by Bradford in: Bradford, Untangling (n 74) 155.
\textsuperscript{80} Ibid at 402.
\textsuperscript{81} Utz (supra n 7) at 912.
\textsuperscript{82} Shaviro (supra n 79) at 400.
\textsuperscript{83} Bradford, Untangling (supra n 74) 155-156.
not a ground for concluding that one person is better off than another.\textsuperscript{84} Shaviro argues that wage rate is a more accurate measure of inequality than income. As Shaviro himself coherently puts it:

\begin{quote}
[A] high wage rate individual may have less wealth, income, or market consumption than a low wage rate individual simply by reason of having different tastes that led to a different commodity choice as between leisure and the goods earned through work. When this happens, the high wage rate individual will misleadingly appear worse off, rather than better off.\textsuperscript{85}
\end{quote}

This high wage rate individual will then face a lower tax burden than their lower wage rate peer. A tax on earnings is assessed without looking at leisure and Shaviro’s example demonstrates that this is inadequate. Traditional bases are poor indicators of ability because they are influenced by different tastes for labour, leisure, saving and spending.\textsuperscript{86} This leads to taxpayers bearing different burdens despite there being no real reason to tax them differently.

The case for endowment tax is rooted in ability to pay. As shown above, there are different ways of judging ability. For example, while Utilitarians prefer welfare as a measure, Egalitarians would prefer opportunity-based measures. However, endowment is a superior measure which can be reconciled with both of these. Endowment is not a political theory in and of itself; it is a base. It is therefore useful to compare it to political theories like Utilitarianism and Liberal Egalitarianism in order to understand its value.

\textbf{(2) Endowment and Utilitarianism}

Utilitarianism, as outlined above, focuses on maximising aggregate welfare within society.\textsuperscript{87} Depending on one’s conception of equal sacrifice and understanding of utility curves, this can lead to a progressive, proportional, or regressive tax system. Assuming a declining marginal utility curve and a progressive rate structure, the ideal is a tax system that strikes a balance which maximises progressivity but minimises the substitution effect.\textsuperscript{88} With these assumptions, Utilitarianism raises two issues about an endowment tax base.

\begin{itemize}
\item \textsuperscript{84} Shaviro \textit{(supra} n 79) at 403; he illustrates this with reference to budget lines and indifference curves at 403-406.
\item \textsuperscript{85} \textit{Ibid} at 405.
\item \textsuperscript{86} Stark \textit{(supra} n 67) at 47; see also: Shaviro (n 77) at 141.
\item \textsuperscript{87} Stark \textit{(supra} n 67) at 53.
\item \textsuperscript{88} Shaviro \textit{(supra} n 77) at 137.
\end{itemize}
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The first of these relates to the substitution and income effects. If the tax base is income, an important issue is how to balance the utility gains to low income individuals, coming from redistribution, with the utility losses caused to high income individuals by the substitution effect (itself caused by the progressive taxation). The replacement of an income tax with an endowment tax entirely removes the substitution effect. Under an endowment tax, one cannot change one’s behaviour to avoid tax. This makes it more efficient and less distorting than an income tax. In this element, endowment taxation is similar to a head tax which similarly avoids the substitution effect.

However, the efficiency of endowment taxes from a Utilitarian perspective can be challenged. It is true to state that there is no substitution effect. However, it is not true to state that there is no distortion. The fact that taxes are paid in money means that there must be some distortion. The income effect for people with high endowments becomes very great indeed. The problem with the income effect in the case of endowment taxation is not its presence (as it is present to some degree in many taxes), but the significance of the distortion caused. Income effects could be more likely to reduce individual utility because it is possible that people would be happier to have more leisure, depending on tastes. An endowment tax produces a much greater income effect on highly endowed individuals than a head tax because of the desire to maximise earnings in order to pay the tax and maintain consumption; therefore, an endowment tax cannot be seen as a neutral baseline simply because it doesn’t entail the substitution effect. Preferring an endowment tax to income or consumption merely prefers one distortion to another. Although he phrases it in terms of a substitution effect, Chorvat presents a similar argument about the distorting effects of endowment tax. His point, though, is the same: endowment tax is not free from distortions.

90 Stark (supra n 67) at 54.
94 Sugin, (supra n 92), at 9.
95 Ibid, at 10.
96 Ibid.
A further question faced by Utilitarians in relation to endowment tax is whether the assumed declining marginal utility curve which is applied to income also applies to endowment. Another way of phrasing this would be to ask whether redistribution from high endowment to low endowment individuals necessarily enhances utility. If a higher wage rate implies greater earnings then a Welfarist approach would support redistribution from high endowment to low endowment individuals. However, this only works because under this assumption, wage rate is tied to overall earnings. Only thus can it reasonably be assumed that redistribution of money based on earnings potential would improve overall utility. This has a number of problems. The first is that it may not be correct to assume that someone with a greater wage rate has greater overall earnings. This is further complicated by differences in taste among individuals, particularly distinctions around work aversion. From a Utilitarian perspective, work aversion could mean that a high endowment person in a low income job (the proverbial “beachcomber”) would suffer a much greater reduction in welfare as a result of the income effect and having to work at all, even just enough to pay the tax.

A further Utilitarian issue with imposing a progressive endowment tax is that a highly endowed person may suffer a great utility loss at the hands of “labour market lumpiness”. It will probably be difficult within the labour market to achieve high wages over a short period with sporadic work hours. This will mean that for two people with the same endowment, marginal utility of money will be greater for the one with lower earnings because they will have to work more hours in order to pay the same tax, or spend a large amount of their life in a profession they hate, leading to considerable disutility.

A counter-argument to the view that both work aversion and labour market lumpiness would reduce utility is that the lesser interest in work may be matched with a lesser interest in consumption. Therefore, using the money to pay tax would have limited impact on utility. It is very possible that some people may receive a utility gain from substituting leisure for work. However, a lesser interest in consumption is far from guaranteed and for those who wish to consume, the disutility caused by the income effect may be great. Weighted

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98 Zelena (supra n 89) at 1151.
99 Stark (supra n 67) at 54.
100 As Shaviro illustrates himself, see: Shaviro (n 77) at 130.
101 Ibid at 137.
102 Ibid.
103 Ibid at 138.
104 Zelenak (supra n 89) at 1152.
105 Shaviro (supra n 77) at 138.
106 Sugin (supra n 92) at 8-9; see also: Griffith (n 93) at 1391.
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Welfarists, with their more Egalitarian leanings, are likely to be less concerned with high endowment individuals being forced into work. However, this only applies up to the point that the impact on utility is significant enough to lower the welfare of individuals in this group to that of the worst off.\footnote{107} 

If people were identical but for their ability to earn then endowment taxation would be the ideal for Utilitarians because of the lack of substitution effect while, in theory at least, allowing progressivity.\footnote{108} However, the effect of lumpy labour markets and the differences in consumption tastes disrupt this utopia. These impacts lead to there being no clear motive for a Utilitarian in having an endowment rather than earnings tax base.\footnote{109} It is possible though that a Utilitarian may conclude that when one balances the redistribution of money in mostly a utility enhancing way\footnote{110} with the minimal substitution effect then endowment may be the best base.\footnote{111} This is dependent, however, on endowment being measurable and the impact of work aversion and consumption differences not.\footnote{112} Adopting this approach, Shaviro submits that, from a Utilitarian perspective, endowment is a more perfect tool than traditional bases for measuring inequality and ability to pay.\footnote{113} It is clear therefore that an endowment tax base could fit with a Utilitarian conception of ability to pay. Equally, however, it is not such a perfect fit that Utilitarians will abandon all other bases and seize endowment as their new aspiration. The Utilitarian opinion on endowment tax could be best summed up as ambivalent.

\section*{(3) Endowment and Liberal Egalitarianism}

The general theme of Liberal Egalitarian thought is, in short, that the results of brute luck should be redistributed whereas things which are the result of individual choices should not.\footnote{114} Although people differ in their financial endowments because of brute luck, the more important differences are in human endowment.\footnote{115} These include genetics and upbringing as well as the value that the market places on the skills with which a person is endowed. In order to lessen brute luck in this context, Egalitarians would urge redistribution from those with above-average ability (or endowment) to those with below-average ability.\footnote{116}
Because of the strong support of individual choices in Liberal Egalitarianism, the theory could support treating equally endowed people the same, irrespective of their chosen profession and therefore income.\(^{117}\) This is because despite now having different incomes, the individuals were faced with the same opportunities. It would be inconsistent for the tax system to attempt to ameliorate the effects of brute luck and be insensitive to choice while treating two equally endowed taxpayers differently because of their choice of employment.\(^{118}\) This is a strong argument in favour of endowment taxation under the liberal Egalitarian theory. Further, it is also a firm argument against income taxation. An endowment tax initially appears to be consistent with equality of opportunity. Furthermore, such a tax is neutral to choice by not favouring either labour or leisure. Shaviro concludes that, “[i]f endowment were measurable, liberal Egalitarians might be more committed than welfarists to basing tax burdens on it.”\(^{119}\)

However, Liberal theorists have offered a number of liberty objections to endowment tax.\(^{120}\) These come in different degrees. The first objection which is frequently engaged by Liberal theorists is the possibility of “talent slavery.”\(^{121}\) This objection arises because taxes need to be paid in money, thus making an endowment tax biased against low paid or non-market work.\(^{122}\) If the labour market is lumpy and a person has a skill with a high market value (with no alternative similarly paid profession available), that person could have to spend their entire year (or applicable period) working in order to pay the tax. This is not a problem provided that the person enjoys this work, but if they do not, or even if they detest it, then this could lead to talent slavery of the highly endowed.\(^{123}\) Liberal Egalitarians have argued that this is an unacceptable infringement on autonomy and breaches the requirement of their theory that individual choices be respected. The most notable objection comes from Rawls. He stated that an endowment tax “would force the more able into those occupations in which earnings were high enough for them to pay off the tax in the required period of

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\(^{117}\) Ibid at 1155.

\(^{118}\) Ibid.

\(^{119}\) Shaviro (supra n 77) at 142.

\(^{120}\) Talent slavery and free choice of occupation will be discussed here. A further objection, levied by David Hasen in: Hasen (supra n 91) (relating to social cooperation) will not be discussed for reasons of space. An analysis of Hasen can be found at: Zelenak (supra n 89) at 1171.


\(^{122}\) Sugin (supra n 92) at 19.

\(^{123}\) Zelenak (supra n 89) at 1156.
time; it would interfere with their liberty to conduct their life within the scope of the principles of justice.”

Stark makes the case that endowment taxation fits with the Liberal Egalitarian framework by comparing Rawls’ liberty objections to endowment with Nozick’s similar objections to income taxation. Nozick had argued that the taxation of earnings is “on a par with forced labour.”

Stark develops Murphy and Nagel’s example of a sculptor and a corporate lawyer to illustrate his point. If both the sculptor and the lawyer have the same endowment, and face a tax bill of 20%, Stark argues that each has to give up 20% of their consumption in order to pay the tax. For the lawyer this is material consumption and for the sculptor it is 20% of his time sculpting. Therefore, according to Stark, the lawyer and the sculptor face the same burden in the sense that each loses 20% of their preferred consumption. This assumes, however, that the labour market is not at all lumpy and that it would be possible to earn 20% of one’s possible endowment with only 20% of one’s time. If labour market lumpiness is minimal then Stark’s analysis is convincing with the exception of two small points. Firstly, while Stark’s analysis defeats the talent slavery objection, there would still need to be some sort of objection for taxpayers who considered the best paid use of their time to be not just dislikeable but immoral, the so called “conscientious objector exception.” Further, Stark’s example employs a low tax rate and it may not seem so palatable if the rate were higher. However, bearing in mind that the base for endowment is larger than for income tax, it is probable that a low rate is all that would be required to match current income levels.

Stark submits that there is no difference in kind between the impact of an endowment tax on the sculptor and an income tax on the lawyer. Further, he argues that the endowment tax should be preferred because it necessarily reaches a broader tax base (i.e. realised and unrealised endowment), whereas the income tax is restricted to realised endowment, thus allowing the liberty cost of the tax to be spread more broadly. To protect the sculptor’s liberty (i.e. to have an income tax), the lawyer must lose more of his consumption bundle in order to fund this. However, even if it were accepted that the lawyer and the sculptor

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126 Murphy and Nagel, *The Myth* (supra n 2) 123.
127 Stark (supra n 67) at 59.
128 A point acknowledged by Stark himself: Stark (supra n 67) footnote 64.
129 Zelenak (supra n 89) at 1158.
130 Ibid.
131 Stark (supra n 67) at 59.
132 Ibid.
133 Ibid at 60.
have the same liberty interest at stake, Liberal Egalitarians could justify distinguishing the lawyer’s case from that of the sculptor in that the lawyer’s choice of occupation makes him less deserving of protection. This is because the lawyer chooses to enter the market. If this is accepted, taxes on earnings would be preferable because they are imposed only on those who choose to enter the market, whereas taxes on endowment are imposed regardless of the choice.

Stark’s equation of Nozick and Rawls is far from universally accepted. In discussing the similarities between Nozick and Rawls, Murphy and Nagel argue that the difference between the two objections is that endowment offers a greater degree of interference with autonomy than an income tax. However, the distinction between Stark and Murphy and Nagel is a difference of assumption rather than one of substance. Murphy and Nagel assume a lumpy labour market and that a highly endowed person is not working to maximise their consumption, whereas Stark assumes the opposite. Which of these analyses is to be preferred depends on which assumptions are more accurate in the real world, something which is substantively unknowable.

Sugin makes a more fundamental criticism of the comparison between Nozick and Rawls. She submits that it is wrong to enter into comparisons between the two because libertarians (like Nozick) have a different conception of “liberty” from Liberal Egalitarians (like Rawls). She argues that Nozick’s objection to income taxation arises because taxation gives the state a partial right of ownership in people. Nozick’s arguments are indeed grounded in an entirely different tax theory than those of Rawls’. However, as explained above, Stark still submits that parallels can be drawn. In contrast, Sugin submits that “even though an endowment tax may not...limit a person’s life choices to rise to the level of ‘slavery’, it is nonetheless unacceptable.”

This lesser Liberal Egalitarian objection to endowment taxation (which Sugin submits that Rawls intended) is separate from, and yet similar to, talent slavery. This objection is that endowment tax violates “free choice of occupation,” which

134 Ibid.
135 This is supported by: J Rawls, “Some Reasons for the Maximin Criterion” (1974) AmEconRev 141 at 145; M G Kelman, “Personal Deductions Revisited: Why They Fit Poorly in an ‘Ideal’ Income Tax and Why They Fit Worse in a Far From Ideal World” (1979) 31 StanLRev 831 at 842
136 Stark (supra n 67) at 61.
137 Murphy & Nagel, The Myth (supra n 2) 123.
138 Zelenak (supra n 89) at 1159.
139 Sugin (supra n 92) at 25.
140 Nozick, Anarchy (n 125) 172.
141 Sugin (supra n 92) at 32.
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Rawls includes on his list of primary goods. Stark offers three counterarguments to this objection. Firstly, despite Murphy and Nagel reaching the opposite conclusion, he argues that it is not clear that endowment taxes violate choice of occupation. This, he argues, is because an endowment tax, like any other tax, requires only that the burden be met and the funds be paid. It is up to the taxpayers to decide themselves how the money should be obtained to meet the burden. Secondly, Stark argues that it is not even clear that choice of occupation deserves any greater protection than any other choices. Thirdly, even if choice of occupation should be protected, it is not clear that non-market occupations should be given preferential treatment. From these, Stark concludes that Liberal Egalitarianism is doing nothing more than arbitrarily assigning greater moral worth to non-market activities above market activities.

Stark’s error, however, is to obscure these otherwise sound arguments against the free choice of occupation objection with Nozick’s objections to income taxation. In this, he goes too far. Nozick is a useful counter to talent slavery but the less generalised objection around free choice of occupation requires more nuanced counterarguments. Comparing the vastly different libertarian and liberal Egalitarian philosophies gives Sugin a means to criticise Stark’s otherwise acceptable arguments against Rawls’ “free choice of occupation” objection. Despite Sugin’s best efforts, though, her argument does not defeat the majority of Stark’s point; only his comparison of the “free choice of occupation” objection with Nozick.

Stark argued that a system is assigning greater moral worth to non-market activities if it does not tax them. Conversely, Sugin argues that to adopt an endowment tax “institutionalises the market” and gives a greater worth to market activity. In support of this, Sugin observes that non-market activities which are socially worthy or highly productive may have a low market value. This suggests that the choice of an endowment tax for Liberal Egalitarians comes down to their ability to accept some limitation on choices in order to redistribute fully brute luck. As observed by Markovits, the redistribution of brute luck and

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143 Murphy & Nagel (*supra* n 2) 123.
144 Stark (*supra* n 67) at 63.
145 *Ibid*.
146 *Ibid* at 63-64.
147 *Ibid* at 64.
148 *Ibid* at 65.
149 However, this is a point conceded by inference by Stark himself: *ibid* at 58.
150 *Ibid* at 65.
151 Sugin (*supra* n 92) at 18.
152 *Ibid* at 16-18
preservation of choices are incompatible aims.\textsuperscript{153} Therefore, Liberal Egalitarians will have to qualify their approach somewhere and it may be that some may accept an infringement on choice of occupation.

\textbf{(4) Ways of making endowment work}

There are ways, however, in which an endowment tax could be modified to mitigate the income effect and make it seem less objectionable to those, Liberal Egalitarian or not, for whom the choice of occupation should be protected. Kaplow adjusts it to create a hybrid of an endowment and income tax so that while the tax will be assessed according to endowment, the actual tax payable is capped so that it cannot exceed 90\% of actual earnings.\textsuperscript{154} Kaplow is correct that this hybrid tax would not raise any greater claims on talent slavery than an income tax.\textsuperscript{155} However, Kaplow’s claim that the hybrid tax would have much the same effect as a pure endowment tax is not true in cases of highly endowed individuals who are earning much below their endowment capacity, i.e. those people that the very aim of an endowment tax is to cover.\textsuperscript{156} Daniel Markovits offers a different analysis of how an endowment tax could be framed to mitigate talent slavery. Markovits’ plan is a complex one focusing on the idea of insurance, in that people may sign up to an endowment tax system coupled with redistribution in order to insure against having low endowment (and therefore low earning potential).\textsuperscript{157} Markovits’ plan provides “an attractive account of endowment taxation as wage rate insurance, and situates the talent slavery concern as a constraint in the design of the endowment tax system, rather than as an argument against endowment taxation in any form.”\textsuperscript{158} Richard Musgrave argues that potential welfare is a preferable measure of endowment than potential earnings.\textsuperscript{159} Musgrave submits that such a tax would mitigate talent slavery objections because it leaves highly endowed people with just as high a level of welfare as anyone else.\textsuperscript{160} However, Musgrave’s analysis assumes that people are identical in all ways except wage rates.\textsuperscript{161} He ignores marginal utility of money, work aversion and labour market lumpiness. Furthermore, Musgrave’s reliance

\textsuperscript{153} See: note 54 above and accompanying text.
\textsuperscript{155} Zelenak \textit{(supra n 89)} at 1160.
\textsuperscript{156} \textit{Ibid}.
\textsuperscript{157} See: Markovits (n 52) at 2305-2313; for discussion on Markovits, see: Zelenak (n 89) at 1160-1162.
\textsuperscript{158} Zelenak \textit{(supra n 89)} at 1162.
\textsuperscript{160} \textit{Ibid} at 632; see also: Zelenak \textit{(supra n 89)} at 1165.
\textsuperscript{161} Zelenak \textit{(supra n 89)} at 1165.
on one measure of utility (wage rate) means that he fails to equalise welfare.\textsuperscript{162} The result of this is that talent slavery would only be mitigated under Musgrave’s proposals, not removed. Musgrave’s approach, like many before him, again comes down to assumptions, the truth of which either make or destroy his arguments.

(5) The lessons endowment taxation can teach the ability to pay

Endowment taxation is riddled with practical problems. A person’s endowment cannot be easily measured. In a pure endowment tax, the need to perform early valuations of a person’s ability and worth makes such a tax impossible.\textsuperscript{163} Endowment is socially constructed and therefore very difficult to define as any realistic measure of ability to earn has to change with time.\textsuperscript{164} However, in having a flexible measure, the purpose of an endowment tax (as a way of levelling natural advantages) is largely defeated.\textsuperscript{165} Once the definition of endowment can be changed then people can evade tax by minimising their ability to earn through the choices they make. This entirely defeats the purpose of endowment taxation. The external cultural impacts on the definition of endowment\textsuperscript{166} and the changing community politics make it too uncertain and indefinable a concept on which to base practically a tax.\textsuperscript{167} On the basis that an actual endowment tax is practically impossible, what can the debate about endowment teach us? Or to put it in Zelenak’s words: “to what extent might it be both practical and desirable to take steps in the direction of endowment taxation, without adopting a full-fledged endowment tax?”\textsuperscript{168}

Talent and leisure are huge untaxed resource under the current tax structure. In order to catch these, Seligman was right; the ability to pay requires to be assessed on a broader tax base.\textsuperscript{169} The question though is which traditional tax bases, either individually or in combination, operate as practical proxies for endowment taxation. The “faculty theory” was better than an earnings tax base but was still not able to cover leisure value. James Mirrlees and the writers of optimal income tax literature treat endowment as the taxation ideal.\textsuperscript{170} However, optimal income

\textsuperscript{162} \textit{Ibid.}
\textsuperscript{163} Kaplow (\textit{supra} n 154) at 1507.
\textsuperscript{164} Sugin (\textit{supra} n 92) at 22.
\textsuperscript{165} \textit{Ibid.}
\textsuperscript{166} As recognised by Shaviro (n 77) at 131 (“possessing a white skin if the customers are racist”).
\textsuperscript{167} Sugin (\textit{supra} n 92) at 22.
\textsuperscript{168} Zelenak (\textit{supra} n 89) at 1173.
\textsuperscript{169} When he argued for a broader base, see: note 73 above and accompanying text.
tax theories prefer earnings because these are observable.\textsuperscript{171} It may be that in a practical world income is the best proxy for endowment.\textsuperscript{172} Shaviro makes many of his arguments based on wage rate. Potential wage rate is the best way of assessing endowment taxation, but what about actual wage rate? A wage rate approach would avoid the problem of defining endowment and ensure that tax burdens are “independent of hours of work”.\textsuperscript{173} However, “[i]f endowment tax is based on wage rates, there is no place to account for the effects of wealth in the tax system.”\textsuperscript{174} If endowment and ability are terms describing the “interactions between a given individual and the world in which” they find themselves, and as such are subjective,\textsuperscript{175} what is the best way of ensuring as objective as possible a tax base?

Sugin, after redefining leisure as “pure recreation,”\textsuperscript{176} argues that money is required for pure recreation and that this “therefore leads not to a conclusion that human capital endowment needs to be taxed, but that we may need to reconsider the way that we tax people who inherit wealth or receive gifts that support their lifestyle.”\textsuperscript{177} As authority for this, she argues that people are more likely to be rich if their parents are;\textsuperscript{178} an approach supported by Bradford.\textsuperscript{179} There are further arguments that are levied by Sugin for the taxation of financial rather than human endowment.\textsuperscript{180} She argues that financial endowment makes people better off than human endowment because financial endowment gives only benefit whereas human endowment requires “hard work and development” in order to reap its benefits.\textsuperscript{181} The implication here would therefore seem to be that while a true endowment tax would be practically impossible, a system can go some way towards taxing leisure by implementing taxation of wealth. Therefore, the lesson from endowment tax is that ability to pay should catch as broad as possible a tax base.

It is submitted that while taxing ability to earn is the underlying objective of every tax system, the ability to pay can best capture this objective under both Utilitarian and Egalitarian philosophies through levying tax on a broad base. If one understands the ability to pay as falling short of an endowment tax, this

\begin{itemize}
  \item \textsuperscript{171} Shaviro (\textit{supra} n 77) at 136.
  \item \textsuperscript{172} Stark (\textit{supra} n 67) at 52.
  \item \textsuperscript{173} Bradford, \textit{Untangling} (\textit{supra} n 78) 156.
  \item \textsuperscript{174} Sugin (\textit{supra} n 92) at 45.
  \item \textsuperscript{175} Shaviro (\textit{supra} n 79) at 406.
  \item \textsuperscript{176} Sugin (\textit{supra} n 92) at 44.
  \item \textsuperscript{177} \textit{Ibid}.
  \item \textsuperscript{178} \textit{Ibid} at 45 note 166.
  \item \textsuperscript{179} Bradford, \textit{Untangling} (\textit{supra} n 78) 158.
  \item \textsuperscript{180} Sugin (\textit{supra} n 92) at 45.
  \item \textsuperscript{181} Sugin (\textit{supra} n 92) at 45.
\end{itemize}
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defeats any talent slavery objections. While choosing traditional bases leaves the substitution effect in play, the actual tax system and rate structure could be arranged so as to mitigate these. The reappearance of the substitution effect may cause objections from Utilitarians. However, given the ambivalence of Utilitarians towards endowment taxation and the distortions caused by the strong income effect under an endowment tax, the Utilitarian objections to a broad, traditional tax base are likely to be minimal. What is therefore proposed here is not an actual endowment tax but instead to take into account a broad range of tax bases when assessing ability to pay. As Shaviro recognised:

Neither income, consumption, nor wealth, is an ‘ideal’ tax base, or one that plausibly reflects what we should ultimately want to tax. Rather, they are imperfect stand-ins for some underlying measure of inequality. Therefore, any choice between tax bases…should be conducted in terms of our underlying aims… 182

E. CONCLUSION

There is a wealth of political and economic theory surrounding the ability to pay. The two main justifications for taxing in accordance with ability to pay, Utilitarianism and Liberal Egalitarianism, are both incomplete and flawed; not least because they rely on income as a tax base. An alternative base for ability to pay, that of endowment, could be looked on favourably by both Utilitarianism and Liberal Egalitarianism. However, because of the practical problems faced by a pure endowment tax and issues, particularly for Liberal Egalitarians, relating to talent slavery concerns, it is more appropriate instead to consider ability to pay with as broad a tax base as possible. This gives the closest proxy to the ultimate aim of taxing endowment. The adaption of ability to pay to this broad measure makes ability to pay a useful framework within which to implement the aims of both Utilitarianism and Liberal Egalitarianism in a tax system. It is therefore far from true that “ability to pay survives as an honoured but empty relic or as an excuse for outmoded analysis.” 183

182 Shaviro (supra n 77) at 143.
183 Utz (supra n 7) at 871.
DO THE RULES ON ‘CAPITAL MAINTENANCE’ ACHIEVE ANY USEFUL PURPOSE?

Alison Sneddon

A. INTRODUCTION

The capital maintenance rules consist of a series of restrictions on the shareholder’s ability to withdraw capital from the company in which they are a member. The company’s capital consists of issued share capital, the share redemption reserve and the capital redemption reserve. The rules are contained in common law principles and the Companies Act 2006, which implements various parts of the European Second Council Directive.\(^1\) The preamble to the Directive states “that provisions should be adopted for maintaining the capital, which constitutes the creditor’s security”\(^2\). The intended purpose of these provisions is creditor protection. It is thought that the preservation of capital shall protect creditors as;

“...the creditor...gives credit to the capital, gives credit to the company on the faith of the representation that the capital shall be applied only for

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\(^1\) Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [1977] OJ L026/1.

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the purposes of the business, and he therefore has a right to say that the corporation shall keep its capital and not return it to the shareholders.” ³

Capital is regarded as the main factor which creditors take into account when assessing the risks associated with a particular company. The capital is seen to be “a ‘cushion’ for the creditors against the risk of default by the company.”⁴ The theory behind the restrictions is that the value attached to capital by creditors should not be diminished throughout the life of the company except in the ordinary course of business, or unless there is compliance with certain creditor protection measures. Otherwise, the security which the creditors rely on would fluctuate according to factors outside their control and they would be left in an unsecured position. If there were no capital maintenance rules then shareholders would be free to reduce the company’s capital and increase the risk to creditors. The capital maintenance rules aim to afford creditors protection by placing limitations on the shareholder’s interference with the company’s capital. These consist of restrictions on distributions, reductions of capital, share repurchases and redemptions and financial assistance from the company for the purchase of its own shares.

This article shall suggest that the capital maintenance rules fail to achieve their intended purpose of creditor protection. By imposing restrictions that are measured solely by reference to capital, the rules fail to address the fact that alternative factors can influence the level of a company’s risk. The security of creditors is not based on capital alone, thus restrictions based solely on capital fail to act as a viable means of creditor protection. Consequently, it shall be shown that the rules impose more restraints on companies than can be justified by their rationale.

B. PART ONE – CAPITAL: THE FLAWS

The capital maintenance rules are based on the premise that creditors rely on capital. The extent to which a sophisticated creditor will do this is, however, questionable. There are a string of issues, unaddressed by the capital maintenance rules, which diminish the value of a company’s capital to creditors.

Capital itself is of minor significance to creditors as it can be inadequate and is valued by reference to out of date concepts. The capital maintenance rules are

³Re Exchange Banking Co, Flitcroft’s Case (1882) 21 Ch D 519 at 533-534, per Jessel MR.
“...not about the broad issue of ensuring that companies are adequately capitalised, but about a narrower and more technical issue concerning the preservation of certain capital reserves...”\(^5\) As a result of this, the rules fail to ensure that a company shelters enough capital in order to cover its obligations to creditors.

The rules focus on the preservation of capital, yet they do not ensure that there is enough capital in the company initially to cover creditors’ risks. Despite the fact that a minimum capital requirement exists for public companies\(^6\), this does not offer enough protection for creditors due to the insignificant level which the figure is currently set at. At £50,000\(^7\), this is a trifling sum in comparison to the average amount of a public company’s debts. Nevertheless, the requirement acts as a barrier to market access. The UK Government set the figure higher than that required by the Second Directive.\(^8\) Other EU member states, such as France, have lower minimum capital requirements which arguably result in greater access to market for entrepreneurs. Through setting the figure higher than required, the UK may have restricted its ability to compete the global market. By contrast, there is no minimum capital requirement for private companies. In theory, the rules allow a private company to be formed with one shareholder holding a one penny share.\(^9\) This has created access to market for entrepreneurs who have little capital; yet harbour wealth creating ideas. Although this can produce valuable socio-economic benefits, it results in unsatisfactory protection for creditors. Research has identified that two thirds of registered private companies have a share capital of £100 or less.\(^10\) Accordingly, a creditor of a private company would in most cases be foolish to rely solely on the company’s share capital to protect them in the event of the company’s insolvency. With such meagre amounts involved, negotiating creditors are reluctant to pin all their hopes on capital. Indeed, research indicates that existing and potential creditors do not any longer regard the amount of a company’s share capital as a significant matter when deciding whether to extend credit to it.\(^11\)

\(^6\) s 761(1), (2) of the Companies Act 2006.
\(^7\) s 763(1)(a) of the Companies Act 2006.
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Other factors, such as cash flow and net assets, provide a more valuable measure of a company’s ability to repay credit as these directly address the future solvency of the company. By taking into account these factors creditors can negotiate loan covenants which include terms specifically tailored to address the risks of each individual company. Rather than relying on the blanket nature of the capital maintenance rules, creditors can increase their level of protection by adjusting their agreements relative to the different risks they face.

The “one size fits all” approach of the capital maintenance rules means that it is possible for companies with completely different levels of risk to be subject to the same restrictions. This fails to assure creditors that the risks they are concerned with are being addressed appropriately. The following example demonstrates this. A Ltd and B Ltd - both private companies with capital of £1,000 - approach a bank, C, for a loan. A Ltd is a research and development company which is working on the development of a new software product. B Ltd is a local provider of mechanical services which has a high client retention rate due to the fact that the nearest competitor is 20 miles away. Although A Ltd and B Ltd have the same amount of share capital, they pose very different risks to the creditor. B has a significantly lower level of risk than A, due to the fact it has incoming revenue, a unique selling point and a strong customer base. A is a riskier venture as it has no established product and no incoming revenue. If C was to rely solely on capital – as the capital maintenance rules predict him or her to do - and extend credit to A and B on exactly the same terms, then this would produce disproportionate results. C would have the same amount of protection in two completely different set of circumstances. It can be seen that the broad brush approach of the rules results in disproportionate, and at times inadequate, creditor protection. Accordingly, “…the European regime imposes an uneven playing field, treating like companies differently and different companies alike, in a random fashion, and fails to meet the needs of creditors.”

Consequently, the size of a company’s capital bears no logical relationship to the creditor protection objective of the capital maintenance rules. Creditors who rely solely on capital will receive protection that is relative to the amount of a particular company’s capital rather than to the risk which that company poses. For this reason, Cheffins states that the share capital is “…an arbitrary number,

12 A similar illustration is given by D Kershaw, Company law in context: text and materials (2009) 747.
14 A similar view is taken by Rickford (supra n 13) 141.
unrelated to economic facts that are relevant to the creditor.”15 The approach adopted by the rules fails to take into account the individual features of a business which shall affect the creditor’s exposure to risk. Therefore, the rules “...are not sufficiently flexible to produce the equivalent of bargained-out solutions.”16

Through negotiating specific contractual terms creditors are able to provide themselves with better protection from the risk of insolvency than the capital maintenance rules can. Capital maintenance rules fail to address the risk of insolvency as they look backwards instead of forwards. Capital is determined partly by reference to the members original share subscriptions. This amount does not reflect the need for the company to retain working capital to minimise the risk of future default. For this reason, it is difficult to understand why the capital maintenance rules place restrictions on companies which are determined by reference to the “historic contributions by shareholders”17 as this is a factor which disregards the risk of future insolvency. Furthermore, these historic contributions are determined by referenced to the balance sheet which does not necessarily represent the amount that a creditor shall receive in insolvency. The share capital does not refer to any specific assets that the company owns and the extent to which it represents specific assets shall change over time; yet this is not reflected in the share capital. Members are able to pay for their shares with non-cash considerations such as goodwill, know-how18, and in the case of private companies, an undertaking to perform services. The value of this consideration to the company may depreciate in the future, however this shall not result in a change to the amount of share capital. Therefore, “…the utility of capital as a yardstick will diminish over time, as the value of the company’s assets bears less and less resemblance to the amount of the shareholder’s capital claims.”19 Creditors who rely solely on capital will be vulnerable to this change in value which is outside their control and knowledge.

C. PART TWO – THE PROBLEMS IN PRACTICE

Overall, the rules fall short of what is required to protect creditors satisfactorily. It appears that the very group the rules aim to protect do not value their existence. For this reason, it is questioned whether the restraints which the rules impose on other groups can be justified. The specific rules shall be considered in

16 Davies, Company Law 91.
18 s 582(1) of the Companies Act 2006.
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turn in order to demonstrate the issues they cause in practice and the impact they have on various stakeholders. It shall be considered whether the capital maintenance rules strike the appropriate balance between the competing interests involved.

The rules impact on creditors, shareholders, companies and the wider society;

“Any return of assets to shareholders increases the risk to creditors; but without a return for investors, companies could not perform and contribute to general welfare, and even creditors would not be in business at all. It is thus a question of reasonable balance, or proportionality.”

The shareholder’s contributions can be seen as a “cushion for the creditors against the risk of default by the company.” Thus, reductions in the capital increase the creditor’s risk. The restrictions on capital limit the company’s ability to pay distributions and accordingly attract investors. The ability of companies to attract investment serves an economic purpose by allowing companies to grow and contribute value to the economy and wider society. The promotion of business not only serves a socioeconomic purpose but it also allows creditors to operate in the market. In short, any restriction on capital can potentially impact on a wide range of stakeholders. It must be ensured that the restrictions imposed on these groups are warranted by the need for creditor protection. Any restraints which go further than is necessary to provide creditor protection shall be an unjustified restriction on shareholders, companies and economic growth. Through analysis of the specific capital maintenance rules, it shall be suggested that the restrictions fail to address the requirements of creditor protection and as a result impose unnecessary restrictions on other stakeholders.

Firstly, the distribution rules shall be considered. A distribution is “every description of distribution of a company’s assets to its members.” The ability of a company to pay distributions, often in the form of dividends, is of paramount importance to a shareholder seeking a return on their capital. The company must pay a reasonable dividend in order to attract and retain members. Otherwise the company shall find it difficult to finance business development through share sales. As a result, the costs of raising capital may increase. An inability to raise capital cheaply and easily may discourage entrepreneurialism, resulting in social

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21 Davies, Company Law 84.
22 s 829(1) of the Companies Act 2006.
disadvantages. The creditors’ interest in being repaid must be balanced against these various interests.

The objective of the distribution rules is to limit the return available to shareholders to an extent which preserves the capital of the company. The rules aim to keep intact the original subscriptions of the members on the basis that creditors rely on this amount for security.23 These rules are justified on the basis that the members are liable to contribute this amount to the assets of a company on its winding up.24 Were there no rules monitoring distributions, opportunistic shareholders would be free to take assets out of the company at the point when they saw insolvency looming and leave creditors to claim from an empty shell. Thus, the law seeks to ensure that the dividend paid to members is not a return of the capital which they have contributed but is instead paid out of funds over and above capital.

This is achieved by requiring that distributions can only be paid out of the distributable profits, which are the “profits available for the purpose”.25 These are a company’s “…accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made.”26 Whether a profit or a loss is “realised” is to be determined by the generally accepted accountancy practice in use at the time the accounts are prepared.27 A distribution is justified by satisfying this criteria with reference to the “relevant accounts”, these being the “company’s last annual accounts”.28 The reliance on capital and accountancy based tests makes these rules a sub-standard means of creditor protection.

Whether or not a distribution eats into the company’s capital may be a trivial matter for creditors as there is no necessity for there to be adequate capital in the company to cover their risk. The distribution rules only keep intact the capital which – as already discussed – is often insufficient. Due to this underlying flaw in the capital maintenance doctrine, creditors will be unsatisfactorily protected unless they take their own steps to secure their lending. This will be the case regardless of further restrictions imposed by the distribution rules. In any case, the rules can be easily avoided. Directors of small private companies can pay

23 A similar view is taken in Re Exchange Banking Co, Flitcroft’s Case (1882) 21 Ch D 519 at 533-534, per Jessel MR.
24 s 74 of the Insolvency Act 1986.
25 s 830(1) of the Companies Act 2006.
26 s 830(2) of the Companies Act 2006.
27 s 843(4) of the Companies Act 2006.
28 s 836(1) of the Companies Act 2006.
29 s 836(2) of the Companies Act 2006.
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themselves large salaries or directors fees rather than issuing themselves a dividend. There is no rule that these amounts are to be paid out of profits.\textsuperscript{30}

Furthermore, the reliance on accountancy based tests fails to provide creditors with the degree of protection they require. Firstly, it is debatable how relevant the “relevant accounts”\textsuperscript{31} are to a creditor. These could potentially be 9\textsuperscript{32} months old for a private company and 6\textsuperscript{33} months old for a public company. There is scope for change in this period, therefore these accounts may not show the true position of the company at the time when the distribution is made. Instead, the accounts are a “single selective snapshot”\textsuperscript{34} of a company’s financial status at a certain point in time. The accounts detail the progression to that point over the preceding year. \textsuperscript{35} However, the creditor’s interest is the solvency of the company and this is a matter for the future. Looking at the past is an “imperfect indicator of future solvency.”\textsuperscript{36}

A second problem with reliance on accountancy based tests is that changes in accountancy standards will result in changes in distribution rules. This may result in undesirable consequences, particularly as accountancy tests have been formed with a view to achieving purposes that are different from those the distribution rules set out to achieve. In some cases, the use of accountancy based tests may appear to be too restrictive on companies. For example, in certain circumstances, unrealised losses shall be treated as realised losses thus impacting on the company’s ability to distribute assets to its members. \textsuperscript{37} If an action for damages is raised following a negligence claim against the company, prudent accounting practice will require that this amount is reflected as a realised loss in the accounts even though a court order to pay has not yet been issued. This may prevent the company from paying a dividend now, despite the fact that they do not actually have to pay the damages until a future point. For this reason, the rules may be seen as too restrictive as they “can inhibit solvent and successful companies from making distributions where such distributions would not threaten creditor interests.”\textsuperscript{38} Additionally, companies are burdened with the cost of keeping up to date with changes in general accepted accountancy practice as it is on the basis of this which they shall have to justify a distribution.

\textsuperscript{30} Re Lundy Granite Co Ltd, Harvey Lewis’s Case (1872) 26 L.T. 673.
\textsuperscript{31} s 836(1) of the Companies Act 2006.
\textsuperscript{32} s 442(2)(a) of the Companies Act 2006.
\textsuperscript{33} s 442(2)(b) of the Companies Act 2006.
\textsuperscript{34} Rickford (supra n 13) 166.
\textsuperscript{35} Rickford (supra n 13) 166.
\textsuperscript{36} Rickford (supra n 13) 166.
\textsuperscript{37} s 841(2) of the Companies Act 2006.
\textsuperscript{38} D Kershaw, “Involuntary creditors and the case for accountancy-based distribution regulation” 2009 2 JBL 140 at 158.
Despite these ambiguities, and the somewhat limited value of the rules to creditors, companies must still comply with these time and cost consuming rules. As the rules adopt a one size fits all approach, even the smallest companies making distributions have to comply with these requirements. This has been described as “a matter of concern [as] such companies need to be able to recognise with reasonable ease and without specialist professional advice what distributions are legitimate.” Instead of allowing this, the rules impose burdensome restraints on companies which fail to be justified as necessary to further creditor protection. The capital of the company is unimportant to creditors due to its inadequate nature. Although it is correct in principle that members should not be able to limit their liability to the detriment of creditors, in practice using capital as a measure of this liability can be almost worthless to creditors. As a result, the distribution rules impose costly restrictions on companies in order to provide a protection to creditors which they disvalue.

The same problems exist with the rules regarding the reduction of capital. The rules in Part 17 of the Companies Act place limitations on the amount by which a company may reduce its capital. These rules address a similar mischief to the distribution rules in that they aim to protect creditors from being left empty handed as a result of shareholders extracting capital from the company when they see insolvency on the horizon. The rules prevent a shareholder from reducing capital and evading their contractual liability to the company unless they comply with certain creditor protection measures, the reason being that:

“...the capital of the company as mentioned in the memorandum is to be the fund which is to pay the creditors in the event of the company being wound up. From that it follows that whatever has been paid by a member cannot be returned to him...so as to take away from the fund to which the creditors have a right to look as that out of which they are to be paid...”

However, as already discussed, creditors no longer place such a strong reliance on capital as this suggests. Instead of considering modern attitudes, the rules continue to impose costly restrictions on companies which are not reflective of current creditor requirements. As a result, it is difficult to justify the restrictions on the basis that they are necessary to provide creditors with protection.

42 Guinness v Land Corporation of Ireland (1882) 22 Ch D 349 at p 375-376 per Cotton LJ.
There is only one way for a public company to reduce its share capital. This is by “special resolution confirmed by the court.” The involvement of the court makes this an expensive procedure. The rules have, to some extent, been relaxed for private companies who can make use of the less burdensome method of a “special resolution supported by a solvency statement”. A solvency statement is signed by every director stating that he “has formed the opinion, as regards the company’s situation at the date of statement, that there is no ground on which the company could then be found unable to pay (or otherwise discharge) its debts.” A solvency based approach is useful for creditors as it considers the future viability of the company. There is suggestion that the capital maintenance rules would better address their purpose of creditor protection if they adopted an overall solvency based approach, such as that in New Zealand, as this would address the core creditor interest of solvency. If a director signs the solvency statement without reasonable grounds this constitutes a criminal offence. Despite the aim of the solvency statement procedure being to reduce the compliance costs for small private companies, some may still decide to use the court procedure in order to be reassured their actions shall not result in a fine or imprisonment.

The company’s freedom in relation to share capital is further restricted by the rules on share redemptions and repurchases. Like the reduction of capital rules, these aim to preserve the capital of the company for the benefit of creditors. Public companies are unable to redeem or repurchase shares unless they can finance this from distributable profits or from the proceeds of a fresh issue of shares. There is a relaxation from the normal capital maintenance rules for private companies which are able to make a payment out of capital to repurchase or redeem their own shares. A certain amount of capital, known as the permissible capital payment, can be applied for these purposes. In order to

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43 s 641(1)(b) of the Companies Act 2006.  
44 s 641(1)(a) of the Companies Act 2006.  
45 s 643(3) of the Companies Act 2006 and Article 2(c) of the Companies (Reduction of Share Capital) Order 2008 (SI 2008/1915).  
46 s 643(1)(a) of the Companies Act 2006.  
47 s 4 of the New Zealand Companies Act 1993.  
49 s 643(4) of the Companies Act 2006.  
50 s 643(5)(a) of the Companies Act 2006.  
51 s 692(2)(a)(i),(ii) and s 687(2)(a),(b) of the Companies Act 2006.  
52 s 709(1) of the Companies Act 2006.  
53 s 710(1) of the Companies Act 2006.
calculate this amount, specialist advice may be required which shall impose yet
further costs on the company. As a special resolution\(^{54}\), directors’ statement\(^{55}\) and
auditors report\(^{56}\) are required this shall result in further professional fees. Once
again, it can be seen that the capital maintenance rules place restrictions on a
company’s actions which creditors may regard as having a minimal impact on
their risk. As a result, the rules act as expensive barriers to legitimate corporate
transactions. A company wishing to buy out a retiring managing director will
require costly advice in order to ensure compliance with these sections and all for
an amount which is most likely disvalued by creditors anyway. Consequently,
these “rules may end up imposing restrictions on company management in return
for benefits which creditors do not want.”\(^{57}\)

Additional constraints are imposed on public companies by the rules regarding
financial assistance. The Second Directive requires that a public company “may
not advance funds, nor make loans, nor provide security, with a view to the
acquisition of its shares by a third party.”\(^{58}\) The UK has implemented this
through the Companies Act 2006 by placing a prohibition on financial assistance
which is given in various sets of circumstances, provided that this is given before
or at the same time as an acquisition of shares takes place.\(^{59}\) It is illegal to give
financial assistance by way of gift\(^{60}\), guarantee, security\(^{61}\) or loan\(^{62}\), or if it
reduces, to a material extent, the net assets of the company by giving the
assistance\(^{63}\), or if it is given by a company which has no net assets.\(^{64}\) The purpose
of the rules is to prevent improper practices which may detrimentally impact on
the value of the company. It is not necessarily beneficial for the company to use
its assets to enable a shareholder to buy shares in the company itself. This is
objectionable for the same reason as reducing the company’s capital— it reduces
the creditor’s equity cushion.

As early as the 1960s the purpose of the rules was rejected as a justification for
the burdens they create. The Jenkins Committee suggested that the offence
should be maintained, but that these transactions should be permitted if approved

\(^{54}\) s 716(1) of the Companies Act 2006.
\(^{55}\) s 714(1) of the Companies Act 2006.
\(^{56}\) s 714(6) of the Companies Act 2006.
\(^{57}\) Davies, Company Law 93.
\(^{59}\) s 678(1),(2) of the Companies Act 2006.
\(^{60}\) s 677(1)(a) of the Companies Act 2006.
\(^{61}\) s 677(1)(b)(i) of the Companies Act 2006.
\(^{62}\) s 677(1)(c)(i) of the Companies Act 2006.
\(^{63}\) s 677(1)(d)(i) of the Companies Act 2006.
\(^{64}\) s 677(1)(d)(ii) of the Companies Act 2006.
by special resolution and made with a certificate of solvency. This reflects the approach taken in the US, where financial assistance is legitimate provided it is approved by the members and entirely transparent. The proposals of the Committee were not accepted, and the current rules remain unsatisfactory in a number of areas. In particular, the scope of the “principal purpose” exemption is particularly ambiguous, as demonstrated in the case of *Brady v Brady*. The unclear extent of this exemption burdens companies with the costs of structuring transactions in order to avoid the effects which the operation of the rules shall create. The penalties imposed by the rules appear to unjustly penalise innocent parties. As financial assistance is a criminal offence this can result in subsequent transactions being declared unenforceable. Consequently, parties unaware of the original financial assistance may be put at a disadvantage by this penalty. The company may be fined if it has given unlawful financial assistance. This detrimentally impacts on shareholders, who in a large public company will most likely have no involvement in the financial assistance.

Nevertheless, the rules on share repurchases and financial assistance do achieve some useful purpose in that they can protect creditors from improper practices and market manipulation. The rules can restrict the opportunity for fraud. This may result from the directors using company funds to buy shares in the market, resulting in increased share prices, then selling the shares in order to realise large profits for themselves but leaving little in the company for other shareholders and creditors. However, these risks are addressed by other, more suitable, legal rules. The Stock Exchange is able to monitor such transactions effectively nowadays and transparency in modern accountancy makes it difficult to conceal such practices. Protection in insolvency law through the wrongful and fraudulent trading provisions provides creditors with remedies in these situations. Also, the directors’ duties and various minority shareholder protection remedies provide protection against improper practices. Unlike the capital maintenance rules, these remedies are not restricted in their application to dealings with capital and therefore are more suited to protecting creditors’ key interests. Accordingly, it is difficult to see whether there are any real benefits of the capital maintenance rules that cannot be addressed in a more useful manner by other legal remedies. If this is the case, and voluntary creditors reject the

65 s 678(2) of the Companies Act 2006.
67 s 680(1) of the Companies Act 2006.
69 A similar view is taken by N Grier, *Company Law* (2009) para 6-03.
70 s 213 and s 214 of the Insolvency Act 1986.
71 s 171-177 of the Companies Act 2006.
notion that capital provides adequate redress in insolvency, then what purpose remains for the rules to serve?

The doctrine of capital maintenance is undermined by virtue of the fact that voluntary creditors do not generally seek to count on capital as a means of protection. The rules are only valuable if creditors can rely on them in practice. If the capital maintenance rules are disvalued by creditors then the distortions which they generate cannot be justified as being necessary to protect creditors. It may be argued that the rules create economic efficiency as they mirror the terms creditors would impose anyway and thus reduce transaction costs. Cheffins argues that unless the legal rules mimic those terms the parties would have selected if contracting in ideal conditions then the restrictions imposed by the law are unjustified. If this hypothetical bargaining model is applied to the capital maintenance rules the restrictions cannot be justified on the basis that they reduce transaction costs. In ideal contracting conditions negotiating creditors would not rely solely on capital as this would fail to provide them with a substantive amount of protection. Despite the limited value which creditors attach to the rules, their operation continues to disadvantage companies, shareholders and society. Accordingly, “the costs of mandatory rules based on legal capital are likely to outweigh their benefits.”

However, this reasoning rests on the assumption that it is only voluntary, negotiating creditors who are set to benefit from the capital maintenance rules. On the other hand, the rules may also provide protection for involuntary creditors such as delict victims, tax authorities and environmental agencies. Be that as it may, capital cannot offer involuntary creditors any more protection than it does voluntary ones. For involuntary creditors “a restriction on the return of capital to shareholders is by itself of little assistance. This is because, if creditors do not adjust, the optimal level of capitalisation by shareholders is zero.” As the amount of capital in a private company can be next to nothing and in a public company is insignificant, the protection offered is minimal. Accordingly, involuntary creditors shall only receive further protection through the benefits which flow from the contractual terms imposed by voluntary creditors. The protection of involuntary creditors is thus a matter of luck, dependent on whether or not voluntary creditors adjust. If voluntary creditors do not adjust, then involuntary creditors shall be poorly protected. Without a prohibition on thinly

73 Cheffins (supra n 15) 264.
74 Armour, ”Legal Capital”13.
75 Armour, ”Legal Capital”12.
76 A similar view is taken by Armour , “Legal Capital” at 12 – 13.
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capitalised subsidiaries, companies shall be able to structure their affairs in order to avoid satisfying the claims of certain involuntary creditors.\textsuperscript{77} Overall, the capital maintenance rules offer neither voluntary nor involuntary creditors the protection they require. On that account, they fail to provide a general creditor protection function.

In any case, there are more proportionate ways for involuntary creditors to be protected rather than through the capital maintenance rules. Trade creditors can rather easily include retention of title clauses in contracts.\textsuperscript{78} Compulsory insurance could be introduced to cover the claims of delict victims.\textsuperscript{79} The premiums could be set relative to the level of a particular company’s risk as this would provide adequate creditor protection and place burdens on companies that are proportionate.\textsuperscript{80} Nevertheless, the capital maintenance rules are unable to compensate for the poor protection afforded to involuntary creditors in other areas of the law. At the point of insolvency, involuntary creditors shall rank behind voluntary creditors with fixed securities. Consequently, there may be very little available for unsecured involuntary creditors regardless of the operation of the capital maintenance rules.

D. CONCLUSION

Although the theory behind the capital maintenance rules is valuable, in practice it cannot be achieved. The theory of achieving creditor protection by protecting certain funds would be beneficial if this were a feature which creditors could, in practice, rely on. However, using capital as the foundation for these creditor protection measures fails to cater to the interests of creditors. Capital provides only a general, and often inadequate, shelter from risk. This cannot address the specific threats which each debtor company poses to a creditor. The main concern for creditors is the risk of insolvency, which is better determined by reference to factors other than capital. Accordingly, capital alone cannot address the mischief which creditors wish to be protected against. An approach based on the future solvency of the company, rather than the preservation of the historic capital, would place sharper focus on the mischief which creditors wish to be protected from.

The capital maintenance rules can offer some protection to creditors by safeguarding a particular amount of capital. However, due to the inadequacies in the rules, this shall not generally provide a particularly valuable amount of

\textsuperscript{77} Adams v Cape Industries plc [1990] Ch 433 (CA).
\textsuperscript{78} s 17 of the Sales of Goods Act 1979.
\textsuperscript{79} A similar view is taken by Armour, “Legal Capital” 12.
\textsuperscript{80} Armour, “Legal Capital” 12.
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protection. Also, it is suggested that in certain circumstances this protection could be achieved by other, more suitable, means. In return for this limited amount of creditor protection, extensive burdens are imposed on other groups. For this reason, it is suggested that the benefit of this limited protection is outweighed by the costs which the rules impose on other stakeholders. Overall, taking account of the costs and the benefits, it is suggested that the capital maintenance rules fail to provide any useful creditor-protection function.
A REPLY TO ALISON SNEDDON ON THE SUBJECT OF CAPITAL MAINTENANCE ON BEHALF OF HERBERT SMITH LLP

Sarah Hawes

The author presents an accessible summary of the arguments against the UK's various capital maintenance rules. The necessity of these rules, and the adequacy of them, has occupied commentators at both a UK and European level for some time.

The changes and simplifications to the capital maintenance rules introduced in 2008 and 2009 by the Companies Act 2006 have, for the most part, been welcomed by practitioners. However, I would agree with the author’s overall conclusion that many of the UK's capital maintenance rules continue to offer little "valuable" protection for creditors. It is for this reason, as the author states, that "voluntary creditors" seek alternative forms of protection, such as banks seeking security for loans. Rather, the rules add to the cost of corporate transactions and reorganisations. The extent to which the inadequacy of these rules can be blamed on the EC Second Company Law Directive, or the ‘gold-plating’ in a number of areas by the British legislature, remains debatable.

I would particularly agree with the author that the minimum share capital requirement for limited companies is nothing but an anachronism. It was originally introduced to protect creditors but in fact it does little to improve their position. It also carries with it a number of disadvantages, not least hurdles for small businesses in accessing limited liability status.

The author also queries whether, "despite the aim of the solvency statement procedure [introduced by the Companies Act 2006] being to reduce the compliance costs for small private companies, some may still decide to use the court procedure in order to be reassured their actions shall not result in a fine or imprisonment". In my experience, this has not in fact been the case. Almost all

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1 Sarah Hawes is a professional support lawyer, working in the corporate department of Herbert Smith LLP in London.
private company reductions of share capital are now carried out by the solvency statement route, in order to avoid the additional costs and timing implications of the court process. In the context of intra-group reorganisations and the freeing up of distributable reserves, this route has become a valuable tool in both practitioners' and corporates' armoury.
A. INTRODUCTION

At the time of writing, the Trump Organisation has finally overcome a series of legal setbacks and started building "the world's greatest golf course"\(^1\) on the Menie estate in Aberdeenshire. The project has been highly controversial from the outset and has faced fierce opposition from local residents concerned that both wildlife and people may be displaced in order to make way for the course. Recent moves to extend the development onto neighbouring land have further fuelled campaigners' concerns. Outline planning permission has already been granted in relation to five additional plots not included in the original planning application and not owned by the organisation\(^2\). Of these five plots, one is owned by Aberdeen Council, which is in negotiations to sell the land to the Trump organisation.\(^3\) The other four are owned by private individuals, all of whom have

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stated that they will not sell. Following reports that Donald Trump had approached Aberdeen Council to enquire about the use of Compulsory Purchase Orders to obtain the land, a motion was put to Aberdeen Council asking the councillors to pledge not to use compulsory purchase powers on the estate. The motion was refused on the grounds that the councillors could not make a decision about an order without being presented with all the facts of each specific case. Consequently, the question of whether the Council could - or should – use compulsory purchase orders to further the development remains without a satisfactory answer. More generally, it is of interest to examine how the use of compulsory purchase powers has developed over recent years and ask whether there has been a serious departure from the principle that these powers were originally developed to protect; that private property may be expropriated if, and only if, doing so benefits the public at large.

B. COMPULSORY PURCHASE ORDERS IN CONTEXT

In their contemporary form, the use of compulsory purchase powers is subject to strict statutory requirements and procedural safeguards. These stipulate that an order can be made in one of two ways: either by a public body exercising powers conferred on them by a general act of Parliament or by a private act of Parliament authorising the use of compulsory purchase powers for a specific purpose or scheme. Which procedure is appropriate depends on the circumstances in each case. In Edinburgh, the latter was recently used to pass the Edinburgh Tram Acts in 2006. When questioned on why it had been necessary to pass these private acts for purchases that the Council could have authorised under pre-existing legislation, the primary reason given by the councillors was that the tram project required the exercise of various powers, not only compulsory purchase. For the sake of clarity and transparency, it made more sense to have them contained in a single private act of Parliament, rather than be authorised separately under different pieces of legislation. If a development requires a compulsory purchase order alone in order to proceed, it would seem to be appropriate only to exercise such powers as conferred by a general act of Parliament.

4 Motion made to meeting of Aberdeenshire Council on 01/10/2009, available at http://www.aberdeenshire.gov.uk/committees/files_meta/802572870061668E802575F60057AB1A%5C%2803%29%20Notices%20of%20Motion.pdf.
What Are the Limits to Compulsory Purchase Powers?

(1) Statutory Provisions

In 2009, the Scottish Parliament Information Centre (SPICe) issued a briefing on the possible use of compulsory purchase orders on the Menie estate, with reference to powers authorised under s 189 of the Town and Country Planning (S) Act 1997 only. This enables local authorities to acquire land that is suitable for development, redevelopment or improvement or that is required in the interests of proper planning in the area. It also states that the development does not need to be done by the local authority itself. In recent years this has been used, for example, to purchase land on a back-to-back agreement to redevelop the centre of Glasgow, although not without contention. In Standard Commercial Property Securities Ltd v Glasgow City Council, a compulsory purchase order was made under s189, but later reduced on the grounds that the decision had failed to take into account certain material considerations and reasonable alternatives for the site. Accordingly, the seemingly broad provisions of the Act are clearly subject to strict limits. However, there are also other acts of Parliament that confer compulsory purchase powers on local authorities, and which are worth considering in relation to the Menie Estate.

Firstly, the Enterprise and New Town (S) Act 1990 allows Scottish Enterprise to acquire land that is unsightly if it is reasonably required to improve it. The land may then be disposed of to a local authority or a development corporation created by the Scottish Executive for use as an open public space. The Trump organisation has stated it is particularly keen to gain control of the neighbouring plots of land because it looks like “a slum”, is an eyesore and requires to be cleaned up. However, a private golf course is, by definition, not an open public space and thus the Trump organisation cannot benefit from the Enterprise and New Town (S) Act.

Secondly, the Local Government (S) Act 1973 states, in s 71, that a local authority may make a compulsory purchase of land for the purpose of carrying out any of their functions. However, it has been suggested that an order may only be made under the 1973 Act if no more specific powers exist elsewhere. In relation to proposed purchases to further the development of the Menie Estate,

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8 Standard Commercial Property Securities Ltd v Glasgow City Council 2001 S.C. 177
the provisions of the Town and Country Planning (S) Act 1997 would exclude the exercise of powers under the Local Government (S) Act.

(2) Planning Objectives

The local authority's planning objectives are set out in the Aberdeen City and Shire Structure Plan and in the Local Plan. The former provides broad guidance on developments up to 2015; the latter contains more detailed provisions. The Structure Plan identifies three strategic growth areas, one of which is Aberdeen to Peterhead, including Balmenie. The Plan states: “This area has important strategic assets and has significant potential. We need to make the best use of the deepwater opportunities at Peterhead harbour, realise the potential of the Menie Estate Golf Resort and look into upgrading Peterhead Power Station”11 (emphasis added).

However, academics and judges agree that in situations where property rights may be interfered with, the relevant statutory provisions must be interpreted restrictively.12 Accordingly, the powers conferred by authorising legislation must be read and applied narrowly, in good faith, and only for the precise purpose specified. The reference to the Menie golf estate in the Structure Plan must not be taken out of context, therefore, but read in line with other provisions of the Development Plan. In particular, attention should be given to sections relating to the environment, employment and infrastructure, which are dealt with in chapters three, five and six respectively.

In chapter three, various issues are listed as being of importance to the Plan, which focuses on the need to foster respect for the environment and promote sustainable development. In particular, specific reference is made to the problem of “increasing demands to exploit the environment for private, not community interests”.13 Given that they have recognised this problem, one might expect the council to oppose environmentally exploitative projects of a private nature, such as the Trump Development. However, this is not explicitly stated. Thus, while it

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12 P B Maxwell On the Interpretation of Statutes (2002) 268 This principle was recently confirmed in Pascoe v First Secretary of State [2006] 4 All ER 1240 in which an order granted pursuant to an “impermissible dilution of the statutory requirement” was held to be invalid.
remains a general issue to be taken into consideration when considering any proposed project, there is no hard and fast rule that must be followed.

In chapter five, a list of general issues related to employment includes: “encouraging sustainable, economic diversity to prepare for an eventual downturn in oil and gas related employment.” One of the strongest arguments in favour of the Trump development is that it will provide needed jobs in the region. However, it must be asked whether these will in fact employ local people and be sustainable, as advocated in the Plan, or predominantly seasonal, as is the enjoyment of golf generally in the north-east of Scotland.

Finally, in chapter six, specific mention is made of the need to develop infrastructure to remove waste, improve community facilities and develop renewable energies and telecommunications. There is no mention of a need for either sport or tourist attractions although, assuming such developments could also contribute to other objectives of the Plan - including creating employment and exploiting the environment for the benefit of the community - these are not ruled out.

(3) Case Law

At common law, compulsory purchase orders are generally justified only if the infringement of individual rights is proportionate to the prospective public benefit. Considering this, the proposals of the Trump organisation can be distinguished from those in the leading case in point. In Smith v Secretary of State for Trade and Industry, confirmation of a compulsory purchase order was held to be justified, even though interference with occupants’ rights could have been minimised if alternative property had been found prior to making the Order. The need to acquire land for the 2012 Olympic Games - a project promising national benefits, subject to its timely completion - outweighed the right of the owners or occupiers of the land to enjoy the property. In this situation, the use of compulsory purchase powers was considered to be a proportionate response. However, when the key facts are changed, such that national benefits are negligible and there is no such pressing deadline for completing the project, the balance of competing interests shifts considerably, as does the proportionate response. Further, although the Menie residents have been made an offer of alternative accommodation, this does not lessen opposition to leaving homes.

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14 Aberdeenshire Local Plan (2006) 53 Section 2 (b).
16 Smith and others v Secretary of State for Trade and Industry and another. [2007] EWHC (Admin) 1013.
17 The residents would be allowed to purchase a new property on the estate at cost price.
where they have lived, worked and raised families for many years. These residents are not interested in the protection of property as an abstract concept, but as part of a broader right of respect for private and family life in a specific property.

(a) Human Rights Concerns
The Human Rights Act 1998 ensures that fundamental rights considerations, such as those mentioned above, cannot be ignored in the process of making or confirming compulsory purchase orders. In addition to the Convention rights, the Act also incorporates Articles 1 – 3 of the first protocol of the European Convention on Human Rights (ECHR) into domestic law, providing substantive protection for property rights. This does not include a right to have or acquire property, but does provide certain guarantees in relation to existing property rights: positively, there is a right to enjoy, use, lend and dispose of property; negatively, there is a right not to be deprived of property.\(^{18}\)

Article 1, Protocol 1 is analysed further in *Sporrong and Lönnroth v Sweeden*,\(^{19}\), and three basic rules are drawn from article 1. Firstly, there is the general right to peaceful enjoyment of property, stated in paragraph one of the article. Secondly, paragraph two lays out conditions under which property may be expropriated by the state. Thirdly, also in paragraph two, there are further conditions under which the state may control the use of property but not actually expropriate it.

Article 1, Protocol 1 is complemented by Article 8; the right to respect for private and family life, and comparable cases may be brought under one or the other or both of these. However, as Deborah Rook states: "...it is difficult to envisage a scenario in which the applicant's case would fail under Article 8 but succeed under Article 1, Protocol 1."\(^{20}\) Similarly, just as the first paragraph of Article 1, Protocol 1 is qualified by the second, alleged breaches of Article 8(1) may be justified by the qualifications of Article 8(2).

In *Howard v UK*\(^{21}\), the compulsory purchase of the applicant's land was held to be a justifiable breach of their rights under Article 8(1) on the grounds that, firstly, the land was ideal for a proposed sheltered housing scheme and without the applicant's land, the scheme could not go ahead. Secondly, alternative

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*Mackx v Belgium* (1979) 2 EHRR 330 at para. 63.
accommodation was provided in the immediate vicinity. Thirdly, full compensation, plus disturbance and removal expenses, was payable. On the facts, this case is interesting in relation to the potential use of compulsory purchase orders in Menie. Similar compensation, disturbance and removal expenses are likely to be offered to the residents, and alternative accommodation has been offered in housing that the Trump Organisation plans to build on the estate, in the immediate vicinity of the residents’ current properties. However, the argument that the land is essential for the completion of the golf course is likely to fail, given that the original plans submitted to the Council specifically showed the course being constructed without the need for additional land. Further, general justification for breach of Article 8(1) in Howard v UK was given by the fact that the proposed scheme was: “...clearly in the public interest...” 22

(b) The “well-being CPO”

The public interest test is often a contentious hurdle for a compulsory purchase order application. There may be some cases in which it is clearer, for example, where land is needed for a major public project, such as building a road, school or hospital, which will directly benefit the general public. However, in recent years, compulsory purchase orders have been granted for a wider range of purposes, from regenerating housing schemes to building new supermarkets. Although these are predominantly private enterprises and generate private profit, they have been deemed to confer a general “well-being”23 on the community and therefore to justify the use of compulsory purchase powers to facilitate their development.

The granting of outline planning permission might be taken as evidence that a proposed development conforms to a council’s planning objectives, which include promoting the community’s well-being, and thereby justifies using compulsory purchase. However, this is an overly simplistic approach that ignores other considerations, such as the perceived merits of the development, the availability of alternative sites and whether expropriation of property is proportionate and appropriate under the specific circumstances. That a council does not object to a particular development does not mean it positively endorses it, to the extent of intervening to ensure its realisation. Controversy over granting planning permission in the first place may have the converse effect; granting permission does not in itself justify intervention, but contesting permission is a

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clear challenge to a development’s conformity with planning objectives. This relates both to the outline permission obtained for the additional plots and the land already owned by the Trump Organisation. Although a compulsory purchase order is granted in relation to a specific site only, if the purpose is to further a pre-existing project, it is relevant to consider the planning, environmental and social impacts of the development as a whole.

C. CONCLUSION

Taking all these considerations into account, the use of compulsory purchase orders to extend the Trump development would initially seem beyond the limits of the local authority's powers. However, those limits are already being stretched. The rise of the “well-being” compulsory purchase order, a commitment to regenerating impoverished communities and a desire to encourage local investment have tipped the balance towards making purchases, as long as they (loosely) meet statutory requirements. This trend has not been explicitly endorsed by the courts however, and the common law position remains that all provisions should be read and applied restrictively. The councillors were offered a chance to confirm this when presented with Martin Ford's motion but, one would suggest rightly, declined to do so. If the motion had been passed, the Trump Organisation would likely have claimed a breach of their Article 6 right to a fair trial, a situation the councillors would be anxious to avoid. Only if an application is actually made can it be properly considered and, following due legal process, rejected.

On the other hand, leaving the prospect of Compulsory Purchase Orders hanging over the Menie residents' heads in the meantime places them in an uncertain and vulnerable position, which is at odds with the relative power enjoyed by the Trump Organisation as it deliberates whether to apply for an Order, which the Council may or may not then grant. If the law aspires to be clear, accessible and non-retroactive, it fails in this instance. If the doctrine of compulsory purchase purports to enshrine proportionality, it also fails in this instance. It may be time to define new limits.
PROPORTIONALITY: DANGEROUS OR DESIRABLE?

Veronica Lopez

Lord Diplock in *Council of Civil Service Unions v Minister for the Civil Service*¹ not only identified three grounds upon which judicial review of administrative decisions can be based, but also envisaged “the possible adoption in the future of the principle of ‘proportionality’”.² Previously, Lord Diplock explained that the principle of proportionality requires the decision-maker not to use “a steam hammer to crack a nut, if a nutcracker would do”.³ However, when the House of Lords (now the Supreme Court of the United Kingdom) was asked to consider this principle as a separate ground of judicial review in the significant case of *R v Home Secretary, ex p Brind*⁴ the majority judges were, in fact, of the view that proportionality is not, and should not, be regarded as such. The judges instead expressed concern towards a possible adoption of the proportionality test, Lord Ackner believing that an “inquiry into and a decision upon the merits cannot be avoided”;⁵ Lord Donaldson reminding that judicial review “is a supervisory and not an appellate jurisdiction”;⁶ and Lord Lowry clearly setting out four reasons why the principle should be denied a higher status.⁷ Rooted in Lord Lowry’s reasons for rejecting the principle of proportionality, and in the comments by the other judges, are concerns with the constitutional principles upheld by the doctrines of the separation of powers and parliamentary sovereignty.

While the argument against the development of the principle of proportionality as a separate ground of judicial review highlights the risks involved, one must also consider the way in which the principle of proportionality has actually been applied by the courts in one form or another and the disadvantages and dangers already present as a result of the *Wednesbury* unreasonableness test. Upon closer inspection, it becomes clear that adopting the principle of proportionality may

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¹ *Council of Civil Service Unions v Minister for the Civil Service* [1985] AC 374.
² Ibid at 410.
⁴ *R v Home Secretary, ex p Brind* [1991] 1 AC 696.
⁵ Ibid at 762.
⁶ Ibid at 721.
⁷ Ibid at 766-767.
not in fact be the dangerous step that some believe it to be, but rather a wise move towards a judiciary which is more transparent and honest with its intentions and procedures or, at the very least, a step that does not necessarily put the judiciary in a position where it is more likely to exceed its jurisdiction than the present situation does.

Among the reasons Lord Lowry suggests for denying the principle of proportionality is the potential undermining of parliamentary sovereignty and the threat to the doctrine of the separation of powers. He argues firstly that “decision-makers . . . are those to whom Parliament has entrusted the discretion and to interfere with that discretion . . . would itself be an abuse of the judges’ supervisory jurisdiction”.\(^8\) The judges in Brind were clearly concerned that if they were to accept the proportionality test, the review of decisions on the basis of proportionality would infringe on the Parliament’s supreme power to legislate. However, it is appropriate to first note that the current grounds of review have been developed by the judiciary without express consent by Parliament. As Sir John Laws has reminded, “Wednesbury standards have not been voted in by Parliament”.\(^9\) Instead, it has been observed that the grounds for judicial review “were given life and nurtured by the courts, yet nowhere is it suggested that they are any less legitimate because of the lack of explicit legislative approval”.\(^10\) Therefore, the development of the principle of proportionality as a ground for review is not in itself an illegitimate use of the judiciary’s power. Garreth Wonginstead suggests that a new “modified theory of ultra vires” has been embraced that implies “an indirect relationship between judicial principles of good administration and Parliamentary intention”.\(^11\) In accordance with this theory, it is assumed that the Parliament actually intends to legislate in conformity with the rule of law and intends for decision-makers, to which it entrusts power, to act fairly, rationally, and in essence, proportionally. Accordingly, one may argue that it is in fact necessary for the judiciary to consider the principle of proportionality when reviewing a decision in order to fulfil its supervisory role.

Lord Lowry also presents the view that judges are not “equipped by training or experience, or furnished with the requisite knowledge and advice, to decide . . . but they have a much better chance of reaching the right answer where the question is put in a Wednesbury form”.\(^12\) Lord Lowry’s statements express the

\(^8\) *Ibid* at 766-767.
\(^11\) *Ibid* at 99.
\(^12\) *R v Home Secretary, ex p Brind* [1991] 1 AC 696 at 767.
concern that the judiciary may go beyond its role in reviewing decisions by replacing what it perceives to be the correct decision for that of the decision-makers in applying the proportionality test. He instead prefers the concept referred to as Wednesbury unreasonableness which was introduced in Associated Provincial Picture Houses v Wednesbury Corporation13 by Lord Greene. The concept is that “if a decision on a competent matter is so unreasonable that no reasonable authority could ever have come to it, then the courts can interfere”.14 Lord Donaldson conveys the same concern when he agrees with Watkin L.J. that the “acceptance of ‘proportionality’ as a separate ground for seeking judicial review rather than a fact of ‘irrationality’ could easily and speedily lead to courts forgetting the supervisory nature of their jurisdiction and substituting their view of what was appropriate for that of the authority whose duty it was to reach that decision”.15 While this appears to be a valid consideration, it is very much based on certain assumptions that must be scrutinised.

Firstly, there is an assumption that the adoption of the proportionality test as a ground of review would involve a lower threshold than that which already exists when considering Wednesbury unreasonableness. However, it has been proposed that the concept of proportionality is in no way novel to British constitutional law and instead Jowell and Lester not only argue that “it has been employed, often under other names, in a number of areas . . . [and] embodies a basic principle of fairness”16 but additionally that “because proportionality advances a relatively specific legal principle -- one that is at any rate far more specific than ‘unreasonableness’ or ‘irrationality’ -- it focuses more clearly than those vaguer standards on the precise conduct it seeks to prevent”.17 Instead of presenting a danger, they believe that “by concentrating on the specific it is more effective in excluding general considerations based on policy rather than principle”.18 This view is shared by others as well, and Lord Slynn suggested in R (Alconbury Developments Ltd) v Secretary of State for the Environment Transport and the Regions19 that “there is a difference between the principle and the approach of the English courts...but the difference in practice is not as great as is sometimes supposed”.20 Lord Slynn in R v Chief Constable of Sussex, ex p International

14 Ibid at 230.
15 R v Home Secretary, ex p Brind [1991] 1 AC 696 at 721.
17 Ibid at 67.
18 Ibid at 67.
20 Ibid at 51.
Trader’s Ferry Ltd \(^{21}\) when considering the \textit{Brind} case first claimed that “the distinction between the two tests in practice is in any event much less than is sometimes suggested” and noted that “the cautious way in which the European Court usually applies this test, recognising the importance of respecting the national authority's margin of appreciation, may mean that whichever test is adopted . . . the result is the same”.\(^{22}\) Bearing in mind these observations, there is no reason to believe that the proportionality test would lead to a lower threshold than currently used when applying \textit{Wednesbury} unreasonableness.

Secondly, there is also an assumption that the courts, in accepting proportionality as a ground of review, would be inviting review of the merits of decisions. Lord Ackner suggests in \textit{Brind} that the European proportionality test of “whether the ‘interference’ complained of corresponds to a ‘pressing social need’” articulated in \textit{The Sunday Times v. United Kingdom}\(^ {23}\) would “ultimately result in the question ‘is the particular decision acceptable?’ and this must involve a review of the merits of the decision.”\(^ {24}\) It is true, however, that in determining whether a decision can be considered \textit{Wednesbury} unreasonable, judges have already used the concept of proportionality and formulated questions very similar to that criticised by Lord Ackner. For example, in \textit{R v Secretary of State for Health, Ex parte United States Tobacco International Inc} \(^ {25}\) Taylor LJ believed that “\textit{Wednesbury} reasonableness requires the Secretary of State not to act disproportionately. The means used by him must be proportionate to the aim in view, having regard to less drastic alternatives which are open to him”.\(^ {26}\)

Recalling Jowell and Lester’s comments already referred to, they have also suggested that “the reluctance to articulate a principled justification naturally encourages suspicion that prejudice or policy considerations may be hiding underneath \textit{Wednesbury}’s ample cloak”.\(^ {27}\) It appears that in fact the vagueness of the present \textit{Wednesbury} unreasonableness ground, illustrated by the different ways that judges have formulated questions determining such unreasonableness, suggests that judges actually have more freedom when determining \textit{Wednesbury} unreasonableness than they would if the courts adopt a well-articulated and specific principle of proportionality. Jowell and Lester support such a claim and insist that “justification by reference to principles is intellectually honest, avoiding as it must the obscurity of a vague test and openly revealing the true

\(^{22}\) \textit{Ibid}. at 439.
\(^{23}\) \textit{The Sunday Times v. United Kingdom} [1979] 2 EHRR 245 at 277.
\(^{24}\) \textit{R v Home Secretary, ex p Brind} [1991] 1 AC 696 at 762-763.
\(^{26}\) \textit{Ibid} at 356-357.
Proportionality: Dangerous or Desirable?

reasons for intervention”. Besides, as Wong suggests, “any tool of judicial review for checking government action may be applied with varying degrees of intensity . . . [and] there is no reason to presume that the courts will show any less finesse in using proportionality against the backdrop of their constitutional role than they currently do with Wednesbury”. In fact, the European Community law test of proportionality has not been applied with the same level of severity and strictness and the courts consider a range of factors when determining how strictly they will review the proportionality of a decision. The European Court of Human Rights also uses the doctrine of the ‘margin of appreciation’ which “involves allowing the domestic authorities a degree of discretion in deciding what is needed to protect various public interests in their own county, even though such interests have an impact on protection for Convention Rights”. There is no reason that the judiciary cannot use the same doctrine to allow for the proportionality test to be applied to different degrees depending on the facts of the case, particularly the nature of the subject of the decision, to ensure that the test is used appropriately.

Lastly, Lord Lowry also argues that stability would be compromised and relative certainty jeopardised with the increase in applications for judicial review. Such conclusions would appear reasonable if the acceptance of the doctrine of proportionality as a ground for judicial review were to extend the judiciary’s power and presumably allow for more successful actions of judicial review. However, after having considered the main constitutional principles that could be in ‘danger’, the weakness of this argument is evident. As there is no reason to suggest that the proportionality test would provide judges with any more power than they currently have when reviewing decisions under the Wednesbury ground, particularly since they already consider questions of proportionality in determining what is unreasonable, it is unlikely that a decision to accept proportionality would open a floodgate to claims. Instead, it is probably the case that those who would attempt to argue under a head of could still use those arguments under the head of Wednesbury unreasonableness. Accordingly, there is no reason to suggest that a significant increase in applications would be sufficient enough to upset the state of things and leave a significantly larger number of people in situations of uncertainty due to the number of pending decisions. His Lordship’s arguments based on stability and certainty, once having considered the strength of the reasons based on constitutional principle, do not actually carry much weight.

28 Ibid at 372.
29 Wong (supra n 10) 102-103.
30 Ibid at 103.
32 R v Home Secretary, ex p Brind [1991] 1 AC 696 at 767.
In conclusion, despite the fact that the majority in *Brind* were expressly concerned with the danger that the proportionality test would pose to doctrines of fundamental constitutional importance, parliamentary sovereignty and the separation of powers, there is less to worry about than first appears and there are advantages rather than disadvantages in accepting the concept as a ground of its own. It is also thought by Jowell and Lester that the “explicit recognition” of proportionality would “greatly strengthen the coherence of our developing system of administrative law”. 33 Moreover, it may be deemed unjustified that while the courts are currently empowered to strike down administrative decisions on the basis of disproportionality as long as the applicants can prove that some aspect of EU law or Convention right has been affected, anything outside these areas are immune. On this precise issue, Wong states that the “lack of consistency smacks of artificially induced distinctions unfounded on any principled consideration . . . [and] if we agree with the fundamental axiom of justice that like should be treated alike, then as a matter of principle we must also concede that a control of proportionality should be available in . . . all deserving cases”. 34 Ultimately, it appears that rather than dangerous, the acceptance of proportionality as a separate ground of judicial review would be a logical and desirable move.

33 Jowell and Lester (*supra* n 16) 51.
34 Wong (*supra* n 10) 95.
THE HASTINGS-BASS PRINCIPLE

Tim Macdonald*

A. INTRODUCTION

The “Hastings-Bass Principle” or “the rule in Hastings-Bass” (“the HBP”) is a judge-made rule of English trust law whereby acts done by trustees which have turned out to have different consequences from those intended (usually a large tax bill) can be declared void. It is separate from both the law of rectification and the law of mistake, for despite its superficial similarities, it has been used where those branches of law do not apply. The rule is a fairly recent development and its limits are still being tested – two of the most important cases were decided in the first half of 2010. The rule has attracted much academic discussion (not to mention concern on the part of Her Majesty’s Revenue & Customs) as to how far it will be allowed to extend, amid warnings that it may turn into a “get out of jail free” card for careless trustees or advisers.

* 2nd-year Accelerated LLB student, University of Edinburgh. This article was originally written as a memorandum for the Scottish Law Commission during a summer work experience placement in June 2010. It was revised for publication on 7 June 2011.
The purpose of this article is to summarise the origins, development, nature and limits of the rule as it exists in English law, and to examine the desirability and likelihood of its being adopted in Scots law should a suitable case arise.

**B. ORIGINS**

The rule has its beginnings in the Court of Appeal’s judgement in *Re Hastings-Bass (deceased).* In 1958, the trustees of a trust created in 1947 by one Captain Peter Robin Hood Hastings-Bass advanced money to a second trust created in 1957 by Peter’s sister Diana. The two trusts had the same beneficiary (Peter’s son William Edward Robin Hood Hastings-Bass, born in 1948), and the purpose of the advancement was to reduce the inheritance tax liability when Peter died, which he did in 1964.

This advancement had several effects, one of which was to create a life-interest for William. At the time the advancement was made, the current understanding of the law was that it would not infringe the rule against perpetuities. However, the House of Lords subsequently overturned that view in *In Re Pilkington’s Will Trusts,* in which it was held that such an advancement should be treated as though it had been made when the first trust came into effect. The result of this “backdating” was that all the effects of the 1958 advancement, except the life-interest, were void *ab initio,* because William was not a “life in being” when the first trust was created in 1947.

When the case came to court, the Inland Revenue (as it then was) claimed that the life-interest was also void, even though it did not itself infringe the rule against perpetuities. They argued that all the effects of the advancement must stand or fall together. Had this argument succeeded, inheritance tax (IHT) would have been payable. But the trustees successfully argued that the life-interest should be allowed to stand, as it was a valid use of the trustees’ discretion which was still to William’s benefit, even after the other effects of the advancement had been found void. This meant that no IHT was payable.

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2 This is a rule of English law which limits the duration of a trust. Until recently the permitted duration, or “perpetuity period”, was 21 years. It is now 125 years (Perpetuities and Accumulations Act 2009, s 5(1)). The rule was complex and easy to breach accidentally. The details are not important for the purposes of this article and will not be further elaborated. Scots law has no such rule, but instead limits the period during which income may be accumulated (Trusts (Scotland) Act 1961, s5; Law Reform (Miscellaneous Provisions) (Scotland) Act 1966, s6).
3 [1964] AC 612.
This was not in itself a surprising decision. It is difficult to see why HMRC should be allowed to nullify the valid discretionary acts of trustees in order to increase a deceased’s IHT bill, and the court showed no great innovation in rejecting that idea. Further, it was clear that the trustees were not at fault – they had been caught out by a de facto retrospective change in the law which they could not have foreseen. What is surprising is the way in which an obiter dictum in the case has been used as a basis for fashioning a rule of which the Court of Appeal in Re Hastings-Bass can scarcely have dreamed. Buckley LJ, delivering the judgement of the court, said:

“To sum up the preceding observations, in our judgment, where by the terms of a trust (as under section 32 [of the Trustee Act 1925]) a trustee is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action notwithstanding that it does not have the full effect which he intended, unless (1) what he has achieved is unauthorised by the power conferred upon him, or (2) it is clear that he would not have acted as he did (a) had he not taken into account considerations which he should not have taken into account, or (b) had he not failed to take into account considerations which he ought to have taken into account.”4

It seems likely that in limb (2), Buckley LJ had in mind a situation such as that which later arose in Martin v Edinburgh DC,5 where the trustees took a decision for political reasons without considering whether it was in the beneficiaries’ best interests. Such a decision would be contrary to the said section 32, which requires the use of its provisions to be “for the advancement or benefit” of beneficiaries.6

But in Mettoy Pension Trustees Ltd v Evans & Ors,7 the final part of this dictum was recast in positive form:

“Where a trustee acts under a discretion given to him by the terms of the trust, the court will interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account.”8

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4 [1975] Ch 25 at 41.
5 1988 SLT 329.
6 See Buckley LJ’s comments at 39.
7 [1990] 1 WLR 1587.
8 [1990] 1 WLR 1587, per Warner J at 1621.
As Matthew Hutton of HMRC points out, this is not the logical equivalent of the original *dictum*, and it leads to much wider implications. Although the statement in *Mettoy* was also *obiter*, as it was again held that the deed in question could not be set aside, it has since been accepted as a basis for setting aside several deeds which the trustees themselves, rather than HMRC, would prefer had not been made. This is despite the fact that *Hastings-Bass* itself was really concerned with severability, not the validity of trustees’ decisions.

The first case to apply the HBP in its modern form was *Green v Cobham*, which concerned a trust set up in the taxpayer-friendly jurisdiction of the British Virgin Islands. In order to avoid UK capital gains tax on payments out of the trust fund, a majority of the trustees had to be either actually resident or deemed resident outside the UK. A trustee actually residing in the UK could be deemed a non-resident trustee so long as he was carrying on a business as a professional trustee. The trust had ten trustees, originally with a precarious 6-4 majority of (actual or deemed) non-residents to UK residents, but in 1990 one of them (a deemed non-resident) retired as a professional, but not as a trustee. This not only took him out of one camp but into the other, meaning that the balance was now 5-5. The crucial majority was lost, and the CGT consequences of this oversight ran into the millions of pounds. The trustees successfully argued, on the grounds of *Mettoy* and *Hastings-Bass*, that a certain deed executed after this change (which set up another trust for one of the beneficiaries using money from the original trust) was void because the trustees had failed to take into account considerations which they ought to have taken into account (namely the CGT consequences), and would not have acted as they did but for this failure.

It will be noted that, unlike in *Hastings-Bass* itself, in *Green v Cobham* the trustees were asking the court to nullify their own act, and that the whole situation had been created by their own carelessness. Most of the subsequent cases have been more similar to *Green v Cobham* than to *Hastings-Bass* itself or to *Mettoy*, in both of which the trustees were defending the validity of their acts. As Norris J aptly put it in the opening paragraph of *Futter v Futter*:

“When the Court of Appeal fashioned for the trustees of the 1947 settlement upon Captain Hastings-Bass a stout shield against an attack upon the validity of their decisions by the Inland Revenue, the members of the court cannot have supposed that they were creating for such trustees a powerful weapon enabling them to attack their own decisions in the face of objections by the Inland Revenue. But that, of course, is what

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11 Taxation of Chargeable Gains Act 1992 s 69(2) (later amended to remove this exemption).
C. DEVELOPMENT, NATURE AND LIMITS

Since Green v Cobham, most of the cases invoking the HBP have extended its remit, but some have restricted it. Recent cases have clarified previously contentious questions about what the principle is and what branch of the law it is a part of, although development of the principle is almost certainly not yet complete.

(1) Limiting cases

The most important limiting case is Breadner v Granville-Grossman, in which the court declined to extend the HBP to cover something the trustees did not do, but would have done if they had appreciated the consequences of not doing it. The trust had four beneficiaries, the settlor’s son and that son’s three cousins. The trustees had the power (but no duty) to turn the settlor’s son into the sole beneficiary, but could only do so before a “closing date”, defined as one day before the oldest of the four reached the age of 25. The trustees misinterpreted this as meaning that the last day on which they could act was the eve of the 25th birthday (as opposed to two days before it), and purported to exercise the power a day too late. Park J said:

“There is a very big difference between, on the one hand, the courts declaring something which the trustees have done to be void, and on the other hand, the courts holding that a trust takes effect as if the trustees had done something which they never did at all. It is a big step from In re Hastings-Bass, not a small one, and I am not willing to take it.”

Another limiting case is Abacus Trust Co (Isle of Man) Ltd v Barr, in which it was held that in order for the HBP to apply, there had to be a breach of duty by the trustees, not merely a mistake, and that the effect was to render the deed in question voidable rather than void. However, both these findings have been disapproved by later cases, and it seems clear that they are not now the law. It will be suggested later, however, that this may be the position in Scotland.

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12 [2010] EWHC 449 (Ch) at para 1.
14 [2001] Ch 523 at 543.
A more lasting limitation was established in Smithson & Ors v Hamilton\(^{16}\), where it was held that the HBP could not apply because the offending rule in the trust settlement needed to be changed, not nullified. The HBP could only nullify, not provide “rectification by the back door” (rectification proper was not available in the circumstances). If the offending rule were omitted, the settlement would have been even more seriously defective, so it had to stand. This case also shows that the HBP is not an aspect of the law of rectification.

A recent case where the court declined to apply the HBP was Thorpe v Revenue & Customs Commissioners\(^{17}\). One of the trustees was the sole beneficiary, and he persuaded the other trustees to give all the money to him outright as per Saunders v Vautier\(^{18}\) (the English equivalent of Miller’s Trs v Miller)\(^{19}\). However, the rule in that case only applies if no more beneficiaries can possibly come into existence, which was not the case here. The transfer was a therefore breach of trust by Thorpe. Thorpe then found himself with a large tax bill and tried to undo the payments, relying on the HBP. It was held that the HBP did not apply as this was a breach of trust pure and simple, not an example of a trustee acting under a discretion given him by the trust terms and then finding that the effects were not as he expected.\(^{20}\) This case therefore moved HBP jurisprudence away from the realms of breach of trust, despite Abacus Trust Co Ltd v Barr.\(^{21}\)

### (2) Extending and clarifying cases

Other cases have looked more favourably on the HBP. In Abacus Trust Co (Isle of Man) Ltd v NSPCC\(^{22}\), the trustee company mistakenly executed a deed of appointment on 3 April instead of 6 April, resulting in a CGT liability of £1.2 million (instead of zero) due to the tax year boundary. The court held (at the trustee’s request) that the deed was void \textit{ab initio} as the trustee had not considered the fiscal consequences of its act and had therefore breached its duty to the beneficiaries. This was despite the fact that there was (unlike in Green v Cobham) quite obviously no general failure to consider CGT. On the contrary, as Sir Robert Walker\(^{23}\) puts it extra-judicially, “capital gains tax was in the forefront of everyone's mind; all the well-remunerated professionals were consciously

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16 [2007] EWHC 2900 (Ch), [2008] 1 WLR 1453.
17 [2009] EWHC 611 (Ch).
18 (1841) Cr. & Ph. 240.
19 (1890) 18 R 301.
20 But fortunately for Thorpe, it was held that since the payments were unauthorised, he had held the money as trustee the whole time, and so no tax-incurring transfer had occurred at all.
21 [2003] EWHC 114 (Ch).
23 Now Baron Walker of Gestingthorpe.
engaged on an artificial tax-avoidance scheme; they simply failed to get the timetable right”.  

Then, in *Burrell v Burrell*, the trustees executed a deed with undesirable IHT consequences following negligent advice from their solicitors who had overlooked a technicality. The court set it aside at the trustees’ request on the strength of the HBP. The issue of whether an “additional” requirement of breach of duty applied (as suggested in *Abacus Trust Co v Barr*) was mentioned but not decided as it was unnecessary in this case. The question as to whether the HBP rendered a deed void or voidable was also left undecided as the claimants had only asked for it to be declared voidable.

*Sieff v Fox*, which concerned the ancestral home of the Duke of Bedford, has now become the usual starting point for Hastings-Bass cases. It contains a thorough review of the case law up to that point, and a summary of the HBP as the judge (Lloyd LJ, sitting as a puisne judge) understood it. The case contains two developments, namely (1) that no breach of duty is required before a deed can be set aside (contrary to *Abacus Trust Co v Barr*), and (2) that two distinct tests exist depending on whether the trustees have a duty to act or a discretionary power. Where there is a duty (i.e. when the beneficiaries can compel the trustees to act), the test is whether the trustees might have acted differently if they had taken the right considerations into account. Where the trustees have discretion as to whether to act or not, the test is whether they would have acted differently.

The final two cases where the HBP has been applied are more recent, having been decided in 2010. In *Pitt v Holt*, the HBP was extended from trustees to receivers under Mental Health Act 1983, as this was also a fiduciary relationship (although the judge, Robert Englehart QC, expressly refrained from holding that it could apply to any fiduciary relationship). The patient’s receiver (his wife) had failed entirely to think about IHT when settling his assets on a discretionary trust, and successfully had the settlement set aside after a large IHT bill arose on his death.

Several noteworthy points can be taken from this case. The first is that, after years of reticence, HMRC chose this case in which to begin their long-awaited

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25 [2005] EWHC 245 (Ch).
26 [2003] EWHC 114 (Ch).
28 Ibid. at para 119.
30 Para 38, ibid. at 1211.
intervention in *Hastings-Bass* litigation between other parties. It seems from the result that a case involving the grieving widow of a man with serious brain damage, most of whose assets derived from damages paid in respect of the road accident which incapacitated him, was not the wisest strategic choice HMRC could have made. As a recent journal article by Giles Richardson puts it, “this was hardly a case of a sophisticated tax planning scheme for some plutocrat and his family which had gone wrong. A supposed danger of [the HBP] is said to be that it allows those with lots of money to seek out ever more ingenious schemes for keeping a fair share of it from the rest of society, safe in the knowledge that those schemes which go wrong can be unravelled at modest cost. Mrs Pitt was not engaged in any such activity.”

Secondly, this case came very close to a kind in which the HBP has never yet been invoked, namely one involving a decision by an individual about his or her own money. The basis for allowing trustees a latitude not granted to individuals has always been that it is unfair to allow innocent beneficiaries to suffer the consequences of trustees’ bad decisions. While Mrs Pitt was technically acting as a fiduciary, the tax burden was to her disadvantage rather than that of her principal (who was, after all, deceased). The HBP was applied nonetheless. Thirdly, it was held that Mrs Pitt’s alternative claim in the law of mistake would have failed, showing that the HBP is a separate branch of the law from mistake.

The most recent HBP case (at the time of writing) is *Futter v Futter*, in which several questions about the nature and applicability of the HBP were resolved. Here, it was clear that there was no failure to take tax consequences into account; it was simply that the advice given to the trustees was wrong. The HBP applied nonetheless. It was clarified that the HBP was not founded in the law of mistake but in the law regulating trustees’ powers, and that it exists for the sake of the beneficiaries, not for negligent advisers (although it is not clear what practical difference this will make as long as the courts continue to force HMRC, rather than advisers, to suffer the tax consequences of unfortunate decisions).

It was also confirmed that there was no relevant difference between “effects” and “consequences”, which had been a point of contention in the past. This meant that the deed could be set aside even though the problem was not with its direct effect (distribution to beneficiaries) but with its indirect consequences (tax liability). Further, the question of whether the HBP renders deeds void or voidable was resolved (at least in the case of private family trusts) – they are void.

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32 [2010] EWHC 449 (Ch).
Another important point raised in *Futter* is that of precedent. All the HBP cases hitherto mentioned, apart from *Re Hastings-Bass* itself, have been first-instance judgements. The entire branch of the law is therefore susceptible to abolition by the first such case to be appealed. This possibility is looking more likely as HMRC becomes more involved – it was given permission to appeal by the judge in *Pitt v Holt*, who commented “It may well be that the time is ripe for the Court of Appeal to consider the rule in Hastings-Bass”.33 However, until that happens, the HBP is binding on future judges at first instance, due to an English rule of precedent that where one judge at first instance has fully considered an earlier first-instance case, the later judge’s decision on the same point is settled law unless he has made a serious mistake. The rule derives from *Colchester Estates v Carlton Industries*,34 and originally concerned cases where the second judge disagreed with the first judge, although *a fortiori* it seems indisputably logical to apply it where the second judge agreed with the first. Accordingly, the HBP has now acquired sufficient judicial support to be formally binding on the High Court (for the time being) – it has effectively become authority for itself, despite not having been considered by an appellate court.

One further case deserves to be mentioned. *Gresh v RBC Trust Co (Guernsey) Ltd & HMRC*35 is a Guernsey case which addressed HMRC’s *locus standi* in applications for HBP relief. The Royal Court found at first instance that HMRC should not be joined as a party, because (inter alia) it was seeking to indirectly enforce a foreign revenue law contrary to a centuries-long-established rule.36 However, the Guernsey Court of Appeal reversed the judgement, and the applicant was refused permission to appeal this ruling to the Judicial Committee of the Privy Council. HMRC’s *locus standi* in such cases is controversial even in the UK,37 so the fact that an appellate court has ruled in HMRC’s favour on this issue despite the additional obstacle of its being outwith its own jurisdiction is likely to be highly persuasive if the same issue arises before a UK court. The original question of whether the HBP is good law in Guernsey remains to be decided (although it has been applied in Jersey: *Re Howe Family Number 1 Trust*38).

33 [2010] EWHC 45 (Ch) at para 41.
36 See *e.g.* *Government of India v Taylor* [1955] AC 491, which reviews authorities going back to the 18th century.
37 See the aforementioned article by Giles Richardson at (2010) 16(5) Trusts & Trustees 336-340.
38 [2009] WTLR 419.
SHOULD THE HBP BE ADOPTED IN SCOTLAND?

At present there appears to be no equivalent to the HBP in Scots law.\textsuperscript{39} This section mentions some arguments for and against the desirability of the HBP’s adoption into Scots law, leaving questions of practicality to the next section.

(1) Arguments against

Despite the history of cross-fertilisation between English and Scots law (which long predates the Union),\textsuperscript{40} some in Scotland may object to “law from over the border” of any kind. It is to be hoped, however, that the arguments for and against the HBP will be considered on their own merits.

More importantly, the HBP may be seen (not unreasonably) as a tax-avoidance mechanism for the rich. The public may justifiably ask why trusts set up (as they usually are) by wealthy people for their own families should be able to avoid paying their fair share of taxes even when their elaborate avoidance schemes go wrong. While this argument is equally relevant both north and south of the border, it may find more favour here, due to the different political tenor.

A third argument against the HBP has been succinctly put by Sir Robert Walker (as he then was), speaking of Abacus Trust Co v NSPCC: “One’s instinctive reaction … is to ask why the Chancery Division, rather than the parties’ professional indemnity insurers, should have to pick up the pieces”\textsuperscript{41} If we accept that on principle people should be responsible for their own actions, it follows that the burden of mistakes would be better borne by negligent trustees or advisers (or their insurers) than by the public purse. Had this been the law applicable to Abacus Trust Co v NSPCC, the negligent trustee company would have paid the tax bill out of its own pocket (presumably with reimbursement from its professional indemnity insurers followed by an increase in its premiums).

Finally, if the HBP is adopted in Scotland by judges (as opposed to by legislation) and subsequently overturned in England by an appellate court, the arguments in favour of the HBP in Scotland which relate to cross-border harmony will instead work against it. Moving too soon could leave us stuck with what would become an outdated anomaly.

\textsuperscript{39} See Matthew Hutton’s aforementioned article, (2006) 5 Private Client Business 293-297 at 293.
The Hastings-Bass Principle

(2) Arguments in favour

While the HBP is not strictly about tax, in reality the motivation for bringing an HBP application is usually to reduce liability for tax. With this in mind, it would be unfair for tax relief to be available to people in one part of a country which is supposed to have a unitary tax regime and unavailable to those in another part. A difference in the law could also exacerbate “conflict of laws” problems, for example where some or all of the trustees or beneficiaries live in a different jurisdiction to that in which the trust was set up (be it Scotland or England and Wales). Which law should apply? If trustees in England pay money to a beneficiary in England, will the fact that the trust was originally set up under Scots law, perhaps decades ago, prevent them from going to an English court for Hastings-Bass relief?

If the HBP in England survives its first appeal, but is not adopted in Scotland when the opportunity arises, the difference between the two jurisdictions is likely to divert trust business away from Scotland and into England (or worse, outside the UK to the Channel Islands, the Isle of Man, or other jurisdictions which rely heavily on English law). This would be detrimental to Scotland’s economy – a consideration which becomes more important the more economically and politically separate Scotland becomes.

The argument in favour of making trustees and their advisers responsible for their own negligence was mentioned as an argument against the HBP. But what about when, as in the original Hastings-Bass case, the law as originally understood and relied on has been restated – to all intents and purposes changed retrospectively – by an appellate court? It is difficult to argue against relief in this situation. Indeed, when such cases arise it could be seen to be Parliament’s fault for not making the legislation clearer in the first place.

On balance, it is submitted that the need for cross-border harmony should prevail over the other arguments, and therefore that it would be preferable for the Hastings-Bass principle to be adopted in Scotland if it survives an appeal in England.

D. WOULD AND COULD THE HBP BE ADOPTED IN SCOTLAND?

If we assume that the HBP is desirable, we are still faced with the problem of how to bring it into Scots law. This section examines the practical likelihood of

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42 Pace Part IV of the Scotland Act 1998.
the HBP’s adoption in Scotland via the various ways in which new law can be made.

(1) Westminster legislation

An Act of the UK Parliament would be the surest way to achieve cross-border harmony: its legislative competence in this area is beyond question, and its Acts can apply on both sides of the border. However, this is very unlikely, for the obvious reason that the government largely controls Parliament, and it is not in the government’s interests to help people avoid paying taxes (as shown by HMRC’s opposition to the HBP). Any Act concerning the HBP would be far more likely to abolish it than to extend it.

(2) Holyrood legislation

Although the Scottish Executive does not control HMRC, the same argument that aiding tax-avoidance is not in the government’s interests applies equally in Scotland. The exception would be if the Scottish Government decided to try to run a Channel-Islands-style economy, using low taxes to attract rich investors – the HBP might then be part of the plan. However, Holyrood’s tax powers are minimal at present, so such an agenda could not be implemented.

Even if we imagine that the Scottish Parliament were persuaded by the arguments in favour of the HBP, and decided to enact it as legislation, would they be able to do so? As previously noted, the HBP is ostensibly about trusts (a private law matter which is within devolved competence) but de facto about tax (a reserved matter). Accordingly, there would be serious questions about whether such a bill would “relate to” reserved matters within the meaning of Section 29 of the Scotland Act 1998. Even if it were found to be technically within competence, it would still have to overcome the hurdle of Section 35(1):

“If a Bill contains provisions—
(b) which make modifications of the law as it applies to reserved matters and which the Secretary of State has reasonable grounds to believe would have an adverse effect on the operation of the law as it applies to reserved matters,
he may make an order prohibiting the Presiding Officer from submitting the Bill for Royal Assent.”

This provision has never yet been used, but it seems not unlikely that it could be if the Scottish Parliament were to pass such a bill.
The Hastings-Bass Principle

(3) Judge-made law

The only body able to introduce the HBP into Scots law which is likely to be inclined to do so is the judiciary. It was, after all, the English judiciary that created the rule in the first place. But assuming they wanted to, and a suitable case came before them, how could they do it? In some fields of the law, such as delict and contract, principles can more easily be borrowed wholesale from English law into Scots law and vice versa. But the HBP has its origins in equity, a branch of law peculiar to England and her jurisdictional descendants. The work done in England by equity is in Scotland spread across the general law.

Moreover, the conceptual nature of a trust in Scotland is utterly different from that in England, although the end result is often much the same. In England, a trust is the consequence of the severance of legal ownership or title (at common law) and beneficial ownership (in equity). Beneficiaries of English law trusts therefore have real rights (of a sort) in the trust property, despite lacking legal title. By contrast, Scotland has a unitary concept of ownership derived from Roman law, and while the precise conceptual nature of Scottish trusts has not been definitively settled, the generally preferred view is that the trustee is owner\(^{43}\) (albeit that the trust patrimony is separate from his personal patrimony), and the beneficiaries merely have personal rights against him.\(^{44}\)

This is reflected in the fact that in most cases a breach of trust results not in voidness or voidability of the transaction but in personal liability for the trustees.\(^{45}\) If a case like Abacus Trust Co v NSPCC were to be brought before the Court of Session now, presumably the insurers of either Abacus or its solicitors (or both, depending on where the fault was deemed to lie) would have to pay the tax bill on behalf of the beneficiaries. In other cases, where it might be less obvious that anyone was Hunter v Hanley\(^ {46}\) negligent (such as in Green v Cobham, or a situation where the law had been restated), the trust fund itself would remain liable to the tax charge incurred by the regretted transaction.

If, therefore, the HBP is to be introduced into Scots law by judges, they will need to start from scratch, developing the concept from principles which already exist in Scots law in relation to Scottish trusts. Presumably such a development, if

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\(^{43}\) This view dates back to the institutional writers: see Stair’s Institutions I,13,7 and Bell’s Principles §1992.


\(^{45}\) The Scottish Law Commission’s Discussion Paper on Breach of Trust does not mention voidness or voidability of acts ultra vires or in breach of trust, but only personal liability of trustees. As the scope of the Discussion Paper is not explicitly restricted to personal liability, it must be concluded that the Commission found no instances of void or voidable acts by errant trustees.

\(^{46}\) 1955 SC 200.
possible at all, would follow similar lines to the original HBP, from a statement of circumstances in which courts might set aside exercises of trustees’ discretion to this actually being done. Has any such starting point already been provided?

Derek Francis\(^{37}\) suggests *Dundee General Hospitals v Bell’s Trs*\(^ {48}\) as such a case. A testator left money to the Dundee Royal Infirmary on condition that at his death it had not been placed under state control, as to which his trustees had sole and absolute discretion. By the relevant time the NHS had been established, and the trustees refused to pay the legacy. The hospital unsuccessfully challenged the trustees’ decision (the House of Lords affirmed the judgement of the First Division). The hospital obviously had a difficult test to meet – needing to prove that no reasonable person could have decided as the trustees did – but, as is made clear by the following *dictum* of Lord Reid, not an impossible one:

> “But, by making his trustees the sole judges of a question, a testator does not entirely exclude recourse to the Court by persons aggrieved by the trustees’ decision. If it can be shown that the trustees considered the wrong question, or that, although they purported to consider the right question, they did not really apply their minds to it or perversely shut their eyes to the facts or that they did not act honestly or in good faith then there was no true decision”\(^ {49}\)

Francis suggests that this is sufficiently similar to the *dicta* in *Hastings-Bass and Sieff v Fox* to be a possible springboard for the HBP into Scots law. But could it really work? The distinctive feature of the HBP is that it does not require *mala fides*, negligence, or other forms of *culpa* on the part of the trustees, but merely a failure (however innocent) to take relevant considerations into account. This rules out Lord Reid’s examples of “perversely shutting their eyes” and “not acting honestly or in good faith” as routes towards the HBP, as they will not produce the desired result in a typical HBP case where the error is perpetrated by accident.

This leaves only “considering the wrong question” or “purporting to consider the right question but not really applying their minds to it”. Both these examples presuppose that there is a right question to be considered. In *Dundee General Hospitals* there undoubtedly was: the trustees were expressly directed by the truster to consider a particular question (whether the hospital was under state control). But would a court be prepared to overturn a decision on the ground of improper consideration of the implied “right question” of whether a particular

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\(^{48}\) 1952 SC (HL) 78.

\(^{49}\) 1952 SC (HL) 78 at 92.
The Hastings-Bass Principle

transaction will incur CGT or IHT charges? A generous court might be, but could it do so if the trustees had considered that question, but either got the answer wrong or slipped up in the execution (as in Abacus Trust Co v NSPCC)? It is submitted that this latter example stretches Lord Reid’s words further than is reasonable. Francis points out that “here, just as in England, in exercising a discretion or power the trustees are bound to give due consideration and weight to all relevant circumstances”, but it is submitted that it is rather optimistic to suppose that, if they do not do so, they will be allowed to undo their decision rather than face the consequences themselves.

A survey of older case law for suitable dicta on court intervention yields even less promising results. In MacTavish v Reid’s Trs, the trustees reduced the beneficiary’s annual allowance from £400 to £300 – the trust terms expressly put this within their discretion. The beneficiary’s father challenged this in the Outer House, but failed to aver mala fides. The challenge therefore failed. Lord Kyllachy said:

“I think it clear that, apart from some very definite and precise averments of mala fides, or, in other words, of abuse by the trustees of the discretion vested in them, the Court cannot review, or even examine, the grounds on which the trustees in the defenders’ position have exercised a discretion, such as that here vested in them.”

If this dictum is still good law, the HBP is unlikely to be applied in Scotland – the trustees (for HBP applicants usually are trustees) would have to aver and prove fraud against themselves, which would itself probably prevent any claim succeeding.

Another instance of judicial opinion on when a court might interfere with trustees’ discretion appears in Dick v Audsley (affirmed without qualification by the House of Lords). A testator had put his whole estate into a trust. His next of kin argued that it was void for uncertainty because, inter alia, “no time limit was fixed within which the estate was to be realised and distributed”. Instead, the timing of the distribution was in the trustees’ absolute discretion. Lord President Dunedin said:

“Now, when trustees have a discretion I think—in the words of one of the learned Judges in one of the cases—that although it is a discretion that

51 (1904) 12 SLT 404.
52 (1904) 12 SLT 404 at 404.
53 1907 SC 953 as Dick’s Trs v Dick.
54 1908 SC (HL) 27, [1908] AC 347 as Dick v Audsley.
will not be interfered with yet, of course, if the trustees maladminister, and refuse to exercise the discretion at all, the Court will find a way of interfering. If you can suppose that here the trustees simply buttoned their pockets and refused to do anything, I cannot doubt that a way might be found of compelling them to act. But even apart from that, surely it would be an almost fantastic result if, where trustees profess no difficulty and are in no way behaving in a way to suggest that they are really acting in fraudem of their trust—it would surely be fantastic to say to them ‘Because conceivably you may act in such a way we will take the whole estate away from you and not allow you to deal with it at all.’ That is what we are asked to do here by holding that this bequest is void [for uncertainty].”

Again, court interference is here limited to cases of either fraud or perverse shutting of eyes or buttoning of pockets. The case is even further removed from the HBP than MacTavish because it involves the idea of deeming done something that has not been done, which (as seen above) even the HBP will not do.

Similarly, in Cuninghame’s Trustees v Duke et al., testamentary trustees were to pay legacies “when my trustees shall find it suitable and convenient to pay the same”. The legatees wanted immediate payment, but the First Division refused to interfere with trustees’ discretion. Lord Deas said:

“A very considerable discretion is left with them, and I am not disposed to take the responsibility of interfering with or superseding that discretion.”

Possibly a more promising case for a starting point is the more recent Callander v Callander, reported in the same year as Hastings-Bass itself. There, Lord Cameron said:

“A transaction in breach of trust is voidable at the instance of the interested beneficiaries, but a breach of trust can be homologated by consent, provided that the consent is freely given by parties competent to give it and in full knowledge of relevant legal facts and circumstances.”

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55 1907 SC 953 at 961.
57 (1873) 11 M 543.
58 (1873) 11 M 543 at 546.
60 1975 SC 183 at 210.
In that case the pursuer had consented to the breach of trust and therefore needed to show that it was not merely voidable but void. He failed.

This case constitutes direct Inner House authority that trustees’ acts can be voidable as opposed to merely giving rise to personal liability.61 Furthermore, any consent by beneficiaries can be vitiated by ignorance of “relevant legal facts and circumstances”, which might conceivably include tax consequences. This raises the possibility that the “strictest” version of the HBP established by Abacus Trust Co v Barr (mentioned above; now disapproved in England), in which trustees’ decisions can be set aside where there has been a breach of trust even without fault, might apply in Scotland. In that case, the settlor asked the trustee to appoint 40% of the fund into discretionary trusts. The trustee misinterpreted the instruction and instead appointed 60%. This was challenged by the settlor nine years later. It was held that this was a breach of trust (even though it arose from a simple misunderstanding rather than fraud) and rendered the transaction voidable.

This case might well get us the HBP as it existed in 2003, though not in the more lenient form in which it has existed since Sieff v Fox. However, it is possible that, if a case like Abacus Trust Co v Barr arose in Scotland today, it would be distinguished from Callander in that in the latter case, the breach of trust was indisputably fraudulent (albeit consented to by all parties at the time). It might easily be held that Lord Cameron’s comments about “a transaction in breach of trust” do not apply to a non-fraudulent breach of trust.

An additional problem is that, in a petition relying on the dictum in Callander, the petitioners would have to be “interested beneficiaries” – unlike in English HBP applications which are typically brought by trustees. The question of whether a tax bill which falls to be borne by the trust is something in which a beneficiary (with merely personal rights against the trustee) can have a relevant interest would be a further hurdle.

It must be noticed that similar results to those of the HBP can sometimes be obtained through either the law of mistake or the law of rectification. The HBP proper is distinct from each of these and has, as mentioned earlier, been held to apply where those doctrines fail. Mistake and rectification, therefore, while not related to the HBP stricto sensu, might conceivably be extended in Scotland to cover cases which in England would require the HBP. Such discussion is, however, beyond the scope of this article.

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61 Although they cannot be void; that this is a difference with English law is pointed out by Colquhoun’s Trs v Marchioness of Lorne’s Trs 1990 SLT 34, which follows Callander.
A prospective HBP applicant in Scotland might be tempted to bypass all considerations of whether the courts can competently give him relief on the grounds of existing case law, and simply submit a petition to the *nobile officium* – the closest thing Scotland has to equity as a separate source of law. Obviously it cannot be known in advance whether this would succeed, and it would depend on all the facts and circumstances of the case, but it remains a possibility. The bar, however, would be high.

In summary, it is submitted that judicial adoption of the HBP into Scots law would not be impossible, but it would require a certain determination on the part of the judges to see it happen. Its development in England appears to have been something of an accident, and a Scottish judge would have every opportunity to refuse to apply it here. Whether enough of them will forego those opportunities and allow the HBP a Scottish existence cannot be predicted, but it is to be hoped for the sake of cross-border harmony and equality of taxation that, if the HBP does become firmly established in England, Scottish judges will have a favourable attitude towards it when the time comes.

**E. CONCLUSION**

It will not have escaped the attentive reader’s notice that both Captain Hastings-Bass and his son, the settlor and the beneficiary in the original case, shared the middle name “Robin Hood”. They almost certainly never imagined that, centuries after their legendary namesake, their case would be carrying on his work of depriving the Crown of Englishmen’s taxes. One wonders what the original Robin Hood would have thought about the fact that the HBP is usually of more benefit to the rich than the poor. But Robin Hood never (as far as we know) came to Scotland. Whether the principle engendered by these latter-day Robin Hoods will do so remains to be seen. Whatever happens, it is to be hoped that we do not end up, inadvertently, with one tax law south of the border and another north.

**ADDENDUM**

Since this article was written, important developments have taken place in England and Wales in relation to the HBP. In particular, the cases of *Pitt v Holt*.

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62 See e.g. *Wang Ping Nam v Minister of Justice of German Federal Republic* 1972 JC 43.

63 [2010] EWHC 45 (Ch).
The Hastings-Bass Principle

and *Futter v Futter*\(^{64}\) were the subjects of a conjoined appeal\(^{65}\) by HMRC in March 2011, in which the Court of Appeal significantly reduced the scope of the HBP. A follow-up article is planned for the next issue of this journal to take account of these developments.

\(^{64}\) [2010] EWHC 449 (Ch).

\(^{65}\) *Pitt v Holt; Futter v Futter* [2011] EWCA Civ 197.
AXA PETITIONERS: CHALLENGING ACTS OF THE SCOTTISH PARLIAMENT

Tom Mulhall

A. INTRODUCTION
B. LOCUS STANDI
C. HUMAN RIGHTS
D. CONCLUSION

A. INTRODUCTION

On June 17th 2009 the Damages (Asbestos-related Conditions) (Scotland) Act was passed by the Scottish government to make clear their position regarding the English House of Lords case of Rothwell. This case considered that the scarring of lung tissue as a consequence of exposure to asbestos (plural plaques) was not actionable under the English law of tort, owing to the lack of either physical impairment or visible damage. The Scottish Government wished to distance itself from this decision and thus passed the aforementioned act to ensure that the Scottish courts did not follow the juridical reasoning of their English counterparts.

This statute resulted in major insurance companies bringing a petition to judicially review the Act under two main grounds; firstly, on the basis that their property rights had been breached by an unwarranted intervention, and secondly that their right not to have their present cases interfered with by retroactive legislation had been undermined. They also challenged the Act on the common law ground of irrationality, citing the concept of Wednesbury unreasonableness espoused by the Government as a basis for this.

1 Rothwell v Chemical and Insulating Company Limited and others [2007] UKHL 39.
3 Associated Provincial Picture Houses v Wednesbury Corporation [1948] 1 KB 223.
B. LOCUS STANDI

Due to the cases’ status as a judicial review the presiding judge (Lord Emslie) initially had to decide if the petitioners had sufficient title and interest to bring such an action. He found in the petitioners favour, for whilst they may not have been directly affected by the legislation, they nonetheless succeeded in that they had to “qualify a live, practical interest in the subject-matter”\(^4\), which applied to both human rights considerations, and to the common law standing. After granting locus standi to the petitioners, the presiding judge proceeded to look at each ground of review in turn.

C. HUMAN RIGHTS

Lord Emslie considered that the contention of the insurers that the legislation interfered with an asset of enormous economic value in the form of the Rothwell judgement (and failing that, the impact that it would have on their capital resources). He found that a case could not be founded on as a possession; due to its uncertain nature, ability to change and the fact that it had been decided in a different jurisdiction (and was thus not binding). This resulted in him finding that no “permanent immunity”\(^5\) existed, and that a judicial decision could not be described as belonging to anyone. Furthermore he found that no direct interference had occurred, that the effects of the legislation in denying the insurers immunity were secondary and that the legitimate aim of the Act was for the good of the public at large.

The submission that the right to non-interference with the petitioners rights under article 6 was likewise treated with scepticism by Lord Emslie, finding that the Scottish Parliament (in creating the legislation) had not intended to deliberately interfere with current or pending judicial proceedings and that the act was again, merely for the good of the sufferers of plural plaques. Furthermore, they did not meet the requirements under the Human Rights Act\(^6\) to be considered victims (and thus gain party status), as they were not one of the two parties connected to the original delictual relationship between employer and employee.

Common Law

When discussing the application of the common law grounds of review, Lord Emslie began by examining previous substantive case law on the subject, namely

\(^4\) Axa Petitioners (supra n 2) para 59.
\(^5\) Ibid. para 189.
Adams v the Scottish Ministers\textsuperscript{7}. This case (on the Scottish implementation of the UK wide foxhunting ban) had held that Acts of the Scottish Parliament were to be afforded the same protection under the common law as that of the UK parliament; that they were to be sovereign and supreme. This decision was not accepted as being correct by Lord Emslie, who began an exhaustive search through the regulatory system behind the Scottish Parliament – the Scotland Act\textsuperscript{8}.

He then postulated that since the Act had no specific provisions relating to the application of common law rules to the legislative process and that in the absence of such a provision the well founded “fundamental right”\textsuperscript{9} of access to the courts would override anything short of an express provision stating the intent of the UK parliament to restrict judicial review. Having decided that Acts of the Scottish Parliament were reviewable he then proceeded to define the parameters of this right of review; that it was only available under the strictest of circumstances with an even more rigorous test than that of Wednesbury Unreasonableness, the Act of Parliament must display; “extreme bad faith”, “improper motive” or “manifest absurdity”\textsuperscript{10}. He concluded that the petitioners had failed to aver anything close to the level of irrationality that would be required to invalidate the Damages (Asbestos-related Conditions) (Scotland) Act and dismissed the petition.

D. CONCLUSION

The result of this case in the Outer House of the Court of Session cannot be understated – even with the subsequent appeal having just been heard by the Inner House – the fact still remains that this decision has been made and a shadow of doubt has been cast over the original authority that the Scottish Parliament is sovereign within its own field. Already there has been strong academic criticism\textsuperscript{11} about the consequences of downgrading the Scottish legislature from a primary to a secondary legislature, with serious political ramifications for the constitutional balance of power between the Parliament and the courts.

\textsuperscript{7} Adams v Scottish Ministers 2004 SC 665.
\textsuperscript{8} Scotland Act 1998.
\textsuperscript{9} Axa Petitioners (supra n 2) para 123.
\textsuperscript{10} Ibid. paragraph 142
ADDENDUM

Since this case review was written there have been two further appeals – first to the inner house of the Court of Session\textsuperscript{12} and the second to the Supreme Court.\textsuperscript{13} The Supreme court ruling follows a similar line of reasoning to that of the Inner House of the court of Session – the Justices begin by finding that the insurance companies do qualify as victims but that the aims of the Scottish Parliament were legitimate and proportionate.\textsuperscript{14}

They do however differ in their reasoning from the Inner House with regards the title and standing of the outside parties with a vested interest in the outcome of the legislation. They found that these plural plaques sufferers and their families are directly affected by the legislation and that the current rules on title and standing have developed too narrowly and should be replaced with just an ‘interest’ test.\textsuperscript{15}

More importantly for this particular piece, Lord Hope stated that although it was obvious that the Scottish Parliament was subject to the supervisory jurisdiction of the Scottish Courts, the current safeguard in place, that all Acts of the Scottish Parliament must be Human Rights compliant, is sufficient.\textsuperscript{16}

To this author’s mind the answer to the question of the constitutional balance of power has been definitively answered by the dicta of Lord Hope. The Scottish Courts have been given specific power to regulate the actions of the Scottish Parliament and that is where their supervisory jurisdiction ends. Time will tell whether Lord Hope’s arguments remain valid in the face of possible independence for Scotland.

\textsuperscript{14} Ibid. per Lord Hope of Craighead at para 23-28, per Lord Brown of Eaton-Under-Heywood at para 73, per Lord Mance at paras 85-87, and per Lord Reed at paras 109-114.
\textsuperscript{15} Ibid. per Lord Hope of Craighead at paras 29-41, per Lord Brown of Eaton-Under-Heywood at para 79 and 81-83, per Lord Mance at paras 93-96, per Lord Reed at paras 124–134.
\textsuperscript{16} Ibid. per Lord Hope of Craighead at para 52.
'Administrative moment and judicial review: outline of an analytical framework'

My main research question is: from a legal theory point of view, what should be the limits for an administrative judge in reviewing a decision by the government or a public body? Specifically: can a court substitute its own decision with the one taken by the administrative being? And if ‘yes’, under what conditions, and why (‘the legitimacy issue’)?

This very structured research question sets and defines both the perimeter and the scope of the work in this sense: my research aims to investigate the relationship, from a legal theory perspective, which exists between these two main ‘moments’ of the modern legal systems, the administrative and the jurisdictional, from the individuals’ interests and rights point of view.

My assumption is that, in many cases, administrative and judicial decisions are similar as to both procedure and content: or, more exactly, that behind both of them there is the same legal ‘empirical activity’: ‘strict law-application’. This is because they both belong to what I will call ‘guarantee functions’, i.e. functions of the state not related to the democratic majoritarian principle, but rather to the rule of law, by which every (public) power should be checked and limited in order to protect individuals’ [fundamental] rights and interests. This means therefore that, in some cases, judicial control upon administrative action could and should be much more penetrating than it is conceived nowadays in the sense that, when some conditions occur, the administrative judge can and should substitute its own decision with the one taken by the public body or agency.

Karen Grudzien Baston

The Library of Charles Areskine (1680-1763): Scottish Lawyers and Book Collecting, 1700-1760

Charles Areskine of Alva, Lord Tinwald (1680-1763) was an important Scottish lawyer and judge. Areskine’s legal career was very successful and he rose to
high positions in the Scottish legal establishment which culminated in his appointment as Lord Justice Clerk in 1748.

Areskine is an interesting figure in the early Scottish Enlightenment not least because he began his career not as a lawyer but as an academic. He was a regent (tutor) at the University of Edinburgh when he was barely out of his teens and from 1707 to 1734 he was the first Professor of the Law of Nature and Nations at Edinburgh. Areskine was also a linguist, a traveller, a client of the earl of Ilay, a friend to philosophers, a patron of the arts, and a book collector. Areskine was already a successful advocate by the time he found favour with the powerful and influential earl of Ilay, later the third duke of Argyll, in the 1720s. Ilay, like Areskine, was a bibliophile. Areskine’s life story also provides a good example of the changing circumstances that members of the elite society of Edinburgh experienced during the early to mid-eighteenth century while considering the impact that the Union of 1707 had on Scots law and politics.

A manuscript which lists of the contents of Areskine’s library survives in the National Library of Scotland. ‘Catalogŭs Librorŭm D. Dⁿ. Caroli Areskine de Barjarg, Regiarŭm Causarum Procūratoris. 1731’ records 1290 book titles. Although it is dated as 1731, NLS MS 3283 acted as Areskine’s library catalogue throughout his life. The latest publication date on the list is 1763, the year of Areskine’s death.

Areskine developed his library based on his educational interests and experiences. As a student at St Andrews and an Edinburgh regent, his academic experiences included the standard subjects of the late seventeenth and early eighteenth century curriculum. The essays he wrote as an Edinburgh regent provide information about his teaching – especially his *Theses philosophicae* (1704) which promote Newtonian theories. Areskine was one of many Scottish law students who travelled to the Netherlands. This temporary student migration influenced the development of the Scottish legal tradition by encouraging the study and use of Roman law. Areskine’s library includes the texts used by Scottish students in the Netherlands and shows his interest in the Roman-Dutch legal tradition as well as in modern theories of natural law and the law of nations which, of course, relate to his professorship at the University of Edinburgh. Areskine was also interested in comparative law and his library included books about the law of Spain, France, Italy, and England.

The thesis uses the study of an individual’s book collection to examine wider themes in eighteenth century Scottish legal, social, political, and intellectual history. Areskine’s library was made up of the books he needed for his profession, the texts he used to better understand the law and its history, and the
books he drew on to enhance his participation in the intellectual milieu of early eighteenth century Britain.

Elizabeth Shaw

'Determinism, Criminal Responsibility and Punishment'

My research examines the implications the “dilemma of determinism” for criminal responsibility, punishment, Scots criminal law and penal reform. This dilemma states that, logically, every action is either: 1) causally determined by factors ultimately outwith the person’s control or 2) undetermined (i.e. random). Neither option seems to leave room for the kind of moral responsibility that could provide a basis for retribution. Debate about this has raged across the millennia without coming close to a resolution.

My research relates this controversy to the standard of evidence in a criminal court: when a trial’s outcome depends on a matter expert witnesses fundamentally disagree about, the accused should not be convicted (R v Cannings). By analogy, equally respected experts in philosophy are divided about retributive responsibility and determinism. It therefore seems morally questionable to inflict punishment on individuals based on retributivist considerations - considerations which involve an extremely contested conception of responsibility. I also explore the practical implications for Scots criminal law of rejecting retributive responsibility and investigate whether a non-retributive theory of punishment is sustainable.

Wei-Sheng Hong

'The Law and Practice for Participation in Multilateral Relations as a Sovereign-restrained Sui Generis Entity in International Law: the Case of the European Union and Maritime Affairs'

The unique character of the European Union (EU) and the complex relationship between it and its Member States renders the issue of the EU’s participation in international organisations and international law-making challenging, even problematic. This holds true not only for the EU and its Member States but also for the international organisations in which they participate, as well as for third state members of that international organisation. The governance of maritime affairs through the participation or non-participation of the EU with or without its Member States in international organisations represents an ideal candidate for
research considering the controversies and challenges in law and practice. Internally, the governance of maritime affairs involves a wide range of policy considerations with competences of different natures distributed among the EU and its Member States; externally, the governance of maritime affairs cannot be managed without cooperation among third states and sub-regional, regional and international organisations and indeed this is covered by a complex matrix of regional and international treaties and organisations.

The objective of the research is to take the external multilateral participation of the EU in maritime affairs as an example to see how, in law and practice, a sui generis entity either refraining from, or being restrained from, claiming sovereignty with a wide range of effective or exclusive competences over its affairs, engages with other international actors in a multilateral context. This research aims to reflect on the challenges such an entity brings, and to seek possible solutions to them.

The anticipated contributions of this project are manifold. From the perspective of the EU and its Member States, it aims to propose solutions to ensure the EU’s (external) multilateral participation is effective and consistent so as to achieve the objectives of the EU and its Member States. From the perspective of international organisations and third states, the research aims to propose possible solutions which ensure the effective governance of an international organisation, by providing models of participation to include sui generis entities which have effective and exclusive competence over their affairs whilst circumventing possible controversies (e.g. issues of over-representation, under-representation and sovereignty). From a more general legal theory perspective, the research aims to reflect on the advantages and disadvantages of the state-member-only approach underlying the formation of the matrix of multilateral fora in international law and practice, and to further reflect on the theoretical controversies of related issues (e.g. effective control, membership in international organisations, recognition, statehood and sovereignty). The approach of the research, and the conclusion drawn therefrom, might also illuminate further research concerning other sovereign-refraining and sovereign-restrained entities in international law.

Maureen O’Sullivan

“Deconstructing Patents at the Edge of Reason”

Maureen O’Sullivan is a part-time, second-year PhD student at Edinburgh and she lectures in law (mainly in Intellectual Property) at the National University of Ireland, Galway. Her supervisors in Edinburgh are Professor Graeme Laurie and
Mr Gerard Porter. The title of her PhD is “Deconstructing Patents at the Edge of Reason”. This topic concerns the patent system and how it has been – or may be - applied to living matter, especially in the area of human/animal hybrids and chimeras. The operation of the patent system has become highly specialised and the definition of “invention” has changed drastically with new discoveries in genetics and biotechnology, over the past number of decades. The patent system involves either, or both, the allocation of temporary property rights or monopolies over such inventions and the success – or otherwise - of patent applications currently depends on where the inventor seeks his or her patent. The process is not very transparent. Nor is it often satisfactory for scientists or their opposite numbers in that morality concerns are often juxtaposed, arguably arbitrarily, with notions of unbridled “progress”. Nor is there much public awareness of patent applications (albeit unsuccessful) such as the Newman-Rifkin for humice and humanzees, among others (pray do “google”!). This thesis encompasses a quest to throw the patent system wide open to public awareness, perusal, inspection, scrutiny and critique. “The public” does not exclude the highly specialised geneticists any more than house wives or husbands: it is all-encompassing. The aim is to enhance the democratic process through a study of anarchic and participatory democratic movements, principally in Latin America, whose grassroots politics may prove inspirational in this uncharted realm. Appropriate models will be sought in order to construct a blueprint for reforming the somewhat opaque and rather secretive or obscure (for those not versed in scientific terminology) patenting system. Whilst objections may be raised about the dangers of public involvement hampering scientific research and progress, ultimately, if appropriately and honestly informed, Maureen believes that progress and public awareness are not mutually exclusive. Should patented technology promise enhanced longevity or disease prevention or cure, all of society needs to be involved in decisions to promote these activities. This PhD seeks to pave the way for democratically infused decision-making in the area of patents on such complex inventions.

Chloë Kennedy

“Guilty as Sin: A Scots National Heritage?”

In my current research I am evaluating whether (and if so, how) the development of Scots criminal law has been influenced by changes in Scottish religious culture and theological orthodoxy. The connections between law and religion and between religion and penology have previously been explored at a general level, but the connection between religion and the criminal law as a composite system has so far remained unexplored. Scots criminal law is particularly appropriate for a study of this nature because Calvinism, with its key aims of maintaining social
cohesion and enforcing moral discipline, has been a prominent feature of Scottish society ever since the Reformation of 1560. Given the overlap in the objectives of Calvinist doctrine and the objectives of the criminal law – namely, promoting social harmony and punishing ‘wrongful’ acts – it is highly likely that the religious climate in Scotland has had some bearing on the way that the criminal law has been shaped and applied.

The more precise aim of my thesis is to uncover how any theological influences have contributed to the presence of legal moralism within Scots law. In addressing this issue I have examined various aspects of the criminal law at different points in time and tried to identify evidence of theological ideology, as well as any connections with especially moralistic features of the law. For example, in the area of criminalization the religious underpinnings of the law might be suggested by the justification given for the law’s content or by the fact that the range of criminal offences coincides with Biblical sins. Similarly, if the authority or source of the criminal law is suggested as being of divine providence, then this suggests that religious influences have infiltrated the criminal law. Another key area of the criminal law on which I have focused is the attribution of criminal responsibility, both from the point of view of general theories of responsibility and from the point of view of the structure of *mens rea* (the mental state which must accompany a proscribed act for it to be a crime).
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- Long Articles (up to 8000 words)
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- Reports

It is not necessary for articles to conform strictly to these word limits but authors should endeavour to ensure that articles are as concise as possible. All submissions, however, must conform to the House Style available from the website. We encourage authors to write new material for the review but we are also happy to accept pieces written in the course of your studies.

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