

The law of mistake: In B -v- C, D and E in the matter of the A Trust [2009] JRC 245

In B -v- C, D and E in the matter of the A Trust the Royal Court took the opportunity to fully review the law of mistake in Jersey concerning the disposal of personal property by an individual into a trust following recent decisions by the English courts.

Following the decision, the Court has confirmed that it may take into account the fiscal consequences of a transaction when dealing with applications of mistake with respect to the disposal of personal property by an individual.

The case of the A Trust (the “**Trust**”) concerned mistake in respect of personal property disposed of by an individual, Mrs B, to the trust. It does not concern a Hastings Bass application where the trustee has by mistake disposed of assets. The court clearly noted that a mistake involving the disposal of personal property by an individual into a trust required a higher test than the “might have” test in Hastings Bass. The justification for this differing approach emanates from case law and in particular the principle that gifts cannot be revoked simply because the donors wish they had not made them and would like to have back the property given.

The Facts

Mrs B was born in 1957 in Kenya. Her parents moved with her to England in 1967 where she still resides. On 26 August 1984, she married Mr F and they had one child, E.

Following the dissolution of her marriage, her advisor, Mr G of H, practising from offices in London advised Mrs B to confirm her non domiciled status and to place assets in an offshore trust. Accordingly Mrs B instructed Mr G to set up the Trust. The Royal Court noted that Mr G never fully explained the terms of the declaration of trust to Mrs B. In fact, Mrs B was not a party to any of the deeds (other than the letter of wishes). Mr G essentially set up the A Trust for Mrs B.

Before setting up the Trust, Mr G gave advice on the UK tax implications. However, in 2007 and 2008 following the appointment of new accountants, Mrs B learned that Mr G had failed to advise that whilst Mrs B had non domiciled status for Income and Capital Gains Tax purposes, she did not have that status for Inheritance Tax purposes (“IHT”). This meant that her entire world-wide estate was subject to IHT, meaning that the disposition into the Trust was immediately chargeable to IHT at lifetime rates, which gave rise to a liability for Mrs B.

Mrs B applied to the court under Article 11 (2) of the Trusts (Jersey) Law 1984 (“**the Trusts Law**”) for a declaration that the Trust established by C, a trust company, was established by mistake and that mistake invalidated the Trust in its entirety.

The Trust was governed by Jersey law and therefore the Court had jurisdiction to hear the matter under Article 5 of the Trust Law. The dispositions by Mrs B of the funds into the Trust were also governed by Jersey law on the basis that Jersey was the jurisdiction with which the transaction had its closest and most real connection.

Mistake

The Court noted that the traditional test for mistake was set out in Gibbon v Mitchell (1991) WLR 1304 that there was mistake where the donor did not intend the transaction to have the effect that it did, whether the mistake is a mistake of law or of fact, so long as the mistake is as to the effect of the transaction itself and not merely as to its consequences or the advantages to be gained by entering into it.

In the recent case of Sieff v Fox (2005) 1 WLR 3811, a review was carried out of the English Law of Mistake. In particular significant reference was made to the case of Ogilvie v Littleboy (1897) 13 TLR 399 in the Court of Appeal, a case which was not referred to in Gibbon v Mitchell. This case set out that to have the property returned to him a donor must show that he was under some mistake

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of so serious a character as to render it unjust on the part of the donee to retain the property given to him. Therefore a broad principle of injustice was set out as the test for setting aside a voluntary disposition.

In short, this test allows fiscal consequences to be taken into account, if they were sufficiently serious. Contrast this approach to the traditional Gibbon v Mitchell test where a mistake must be as to the effect of the disposition, and a mistake as to its consequences is not sufficient. Therefore under the old test, fiscal consequences of the transaction are probably irrelevant and accordingly a misunderstanding of such fiscal consequences would probably not justify setting the disposition aside.

Whilst Sieff v Fox did not deal with this point as the case involved a Hastings Bass application made by a trustee, in an obiter statement, Lloyd LJ gave his support to the Ogilvie v Littleboy test by stating that “mistake as to the tax consequences ... are quite sufficient to vitiate the giving of ... consent”.

Since Sieff v Fox, the Isle of Man Courts have applied the Ogilvie test in Petition of McBurnie, the Betsam Trust (2008) unreported, and found that fiscal consequences were sufficient to set aside a transaction, and in the recent decision of Ogden v Trustees of the RHS Griffiths 2003 Settlement (2008) EWHC 118; (2009) 2 WLR 394 the Ogilvie test was applied as being the correct test, but that in applying the Ogilvie test, the Court must be satisfied that the donor or settlor would not have entered into the transaction “but for” the mistake.

Turning to the facts of the case, Mrs B’s mistake was not one which concerned the effect of the disposition into the Trust. It was a mistake as to the fiscal consequences. Indeed, it was a mistake of law in that, unbeknown to her, she was in fact deemed domiciled for IHT purposes giving rise to an immediate and substantial charge. But for the mistake, Mrs B would not have made the disposition. On the balance of probabilities the Royal Court concluded that Mrs B had not been advised of and did not understand the terms of the trust and was mistaken as to its effect. For that reason, the Royal Court declared the Trust to be invalid and that the disposition of the full sum should be set aside.

Is the disposition void or voidable?

Commissioner Clyde Smith assessed the position in some detail as to whether the disposition was void ab initio or voidable. The reason for so doing is based on tax reporting obligations. If the

dispositions are declared void ab initio, there would be no reporting obligation, since there would have been no transfer of value. If the disposition was voidable and subsequently declared void, this would imply that there is a reporting obligation exists. The tax liability would have arisen and Mrs B would have to claim a repayment from the tax authorities.

Where the exercise of a fiduciary power is open to challenge on a Hastings Bass principle, the exercise is void ab initio. However, as already noted above, there is a distinction between mistakes by individuals with their own property and mistakes by trustees exercising fiduciary powers since an individual is not obliged to take account of all relevant considerations and is free to take account of irrelevant considerations. In Ogden, Lewison J commented that the transaction must have had some legal effect and accordingly the transaction ought to be declared voidable as opposed to void ab initio. The Royal Court found his argument persuasive. The Trust was accordingly declared voidable.

Implications for Trustees

Trustees should ensure that donors disposing of personal property into a trust are properly advised and in circumstances where a trust is established, trustees should ensure that donors understand the terms of the trust and its effects. To avoid difficulties in proving such advice, if any matter should proceed to court, detailed notes should be taken at all times. It may also be prudent for trustees to obtain written legal and tax advice which they are able to pass onto the donor.

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