Jersey Royal Court clarifies and affirms the Jersey test for rectification

Insights - 14/09/2022

In the recent decision of *The Representation of Vistra Fiduciary Limited* [2022] JRC 164, the Royal Court moved away from the Court of Appeal's preferred test for rectification of a trust instrument set out in *B&C v Virtue Trustees (Switzerland) AG* [2018] JCA 219, and reaffirmed the well-established three stage test in *Walbrook Trustees v Amethyst Trust* [2002] JRC 186 and *R.E. Sesemann Will Trust* [2005] JLR 421. In doing so, the Royal Court considered that it was not "bound by the propositions of law" referred to by the Court of Appeal as they were not the subject of argument by the parties before the court.

This is a significant decision for trust practitioners to be aware of, and a salutary reminder to ensure that a trust instrument aligns with the intention of the Settlor. It is also a rare example of the Royal Court moving away from a decision by the Court of Appeal.

Background to *Vistra Fiduciary Limited* [2022] JRC 164

The case concerned an application by Vistra Fiduciary Limited, the Trustee of a discretionary trust called the Maria Trust, to rectify the trust instrument to specifically add the Settlor to the definition of "Excluded Person". This was to ensure that the Settlor was expressly excluded as being a potential beneficiary under the trust for the purposes of legitimately avoiding inheritance tax.

The Settlor's son, F, in 2008 wished to buy a property in the UK for him and his family to live in. F's father (the Settlor's husband) was suffering from terminal cancer in 2009 and the Settlor and her husband wanted to assist their son to purchase a property. Unfortunately, the Settlor's husband passed away before the property purchase took place.

F took tax advice from HMG Law as to whether he should purchase the property in his own

name or via a trust. The advice from HMG was clear that an offshore discretionary trust was the best way forward to mitigate inheritance and capital gains tax. HMG Law reached out to the Trustee regarding the establishment of the Maria Trust. The purpose of setting up the trust was clearly recorded in an e-mail from the Trustee to HMG, which stated: "The Trust will be discretionary which will acquire/hold a UK residence as its principal asset to be occupied by the principal beneficiary for the purposes of inheritance tax and capital gains planning."

The Trustee provided a draft trust instrument to HMG Law for review, which was approved. The Maria Trust was established by the Settlor, with F, his wife and issue as the beneficiaries, G as a protector and the Trustee named as the only excluded person. However, there was no mention of the Settlor being excluded. The UK property was purchased using funds derived from a Panamanian Holding Company (wholly owned by the settlor) and held on trust for F and his family.

In November 2016, upon receipt of further tax advice from Charles Russell Speechlys (**CSR**), it transpired that there was a risk that the trust assets could be subject to inheritance tax, as the Settlor could be added as a beneficiary of the Maria Trust. The firm advice from CSR was that in order to mitigate that risk, the Settlor had to be expressly excluded as a beneficiary of the Maria Trust. Consequently, an instrument of exclusion was purportedly executed on 5 May 2017 by the Trustee pursuant to clause 9 of the trust instrument. However, the instrument of exclusion was likely to be invalid as the consent of the protector, G, had not been sought nor obtained at the time.

The Settlor passed away in February 2019. Further tax advice was received from CSR regarding the inheritance tax issues. CSR advised that there was an inheritance tax liability and further advised that the present application for rectification of the trust instrument to include the Settlor within the definition of "Excluded Person" would result in the elimination of that liability.

An application for rectification of the trust instrument was brought before the Royal Court. The Royal Court considered the cogent evidence available from 2008 in relation to the intention of the Settlor at the time the Maria Trust was established, including the affidavit evidence from inter alios, F, G, and HMG Law.

The test for rectification of a trust instrument

The Royal Court set out the well-established three stage test for rectification in *Walbrook Trustees v Amethyst Trust* [2002] JRC 186 and *R.E. Sesemann Will Trust* [2005] JLR 421. The latter case sets out the test as follows:

> "12. The test for rectification in Jersey is well established. There are three requirements:
>
> i. the court must be satisfied by sufficient evidence that a genuine mistake has been made

so that the document does not carry out the true intention of the party(ies)

ii. there must be full and frank disclosure

iii. there should be no other practical remedy. The remedy of rectification remains a discretionary remedy

"13. The important aspect in this case is whether the first requirement is met. There is a clear distinction to be drawn between the transaction itself and the objective behind the transaction. The court can rectify a deed which does not reflect the transaction which the parties intended to achieve but the court cannot use rectification as a method of allowing the parties to achieve some other transaction which, in hindsight, would have been more desirable"

The Royal Court explained that it was required to apply the civil standard of proof to the question of rectification, and therefore it was to determine whether on "the balance of probabilities" there is sufficient evidence that a "mistake has been made so the document does not carry out the true intention of the relevant parties."

The Royal Court however was cognisant of the Court of Appeal decision in *B & C v Virtue Trustees (Switzerland) AG* [2018] JCA 219 (***B&C***). In *B&C* the Court of Appeal preferred the test for rectification as formulated in Lewin at paragraph 4-069, with a number of additions.

"The conditions which must be satisfied in order for the court to order rectification of a voluntary settlement are as follows:

"1. there must be convincing proof to counteract the evidence of a different intention represented by the document itself

"2. there must be a flaw (that is an operative mistake) in the written document such that it does not, on its true construction, give effect to the Settlor's intention

"3. the specific intention of the Settlor must be shown; it is not sufficient to show that the Settlor did not intend what was recorded; it must also be shown what they did intend; and

"4. there must be an issue capable of being contested between the parties affected by the mistake notwithstanding that all relevant parties consent

"To these requirements I would add that there must be full and frank disclosure; that no other remedy is available to achieve the same end; and that even when the requirements for rectification are satisfied the court retains a discretion whether or not to rectify." (The **reformulated test**.)

Interestingly, the Court of Appeal, without hearing argument from the parties, determined that:

"It seems to me clear, both from the reference in *Re Smouha* to the English cases having been taken into account in the formulation of the Jersey requirements and from the equivalence in substance of the relevant requirements in Jersey and England, that there is no difference between the law of England and the law of Jersey relating to the rectification of voluntary settlements. In my judgment, the first requirement set out in *R.E. Sesemann Will Trust* is too summarily expressed; and I prefer, and would adopt, the formulation set out in paragraph 4-069 of Lewin, with the additions I have identified in paragraph 22 above."

The Royal Court referred to the case of *Murray v Camerons Limited* [2020] JRC 179, as authority that it was not to be bound by the Court of Appeal's decision in *B&C*, to adopt the reformulated test because the point on which the Court of Appeal proceeded was not argued before it. The Royal Court was of the view that the two tests although similar in parts were also sufficiently different. Specifically, the Royal Court was also reluctant to adopt the reformulated test where part four of the reformulated test, "an issue being capable of being contested", had proved problematic for the English Courts and had been subject to criticism.

The Royal Court therefore clarified and affirmed that the test to be applied was the three stage test as established in *Walbrook Trustees v Amethyst Trust* [2002] JRC 186 and *R.E. Sesemann Will Trust* [2005] JLR 421. In applying the three stage test, the Royal Court approved the rectification of the Maria Trust to exclude the Settlor as a beneficiary.

Conclusion

Although the Royal Court gives deference to and usually follows the law determined by the Court of Appeal, there are clearly exceptions to that practice in appropriate cases such as this. It is acknowledged that often the Royal Court also has regard to English case law and texts such as Lewin when determining applications concerning Jersey trusts. However, Jersey does have its own identity and has taken a different approach to the English Courts with respect to aspects of trust law such as mistake and now rectification. In this particular case, it is clear that the Royal Court saw little reason to depart from the established three stage test that had been a part of Jersey Law since 2002. On the basis that the Court of Appeal had not determined that the three stage test was wrong, and because the Court of Appeal had not heard argument regarding the appropriate test for rectification, the Royal Court was not afraid to depart from the view taken by the Court of Appeal, and to reaffirm the three stage test.

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