Escaping from mistakes as to tax consequences in respect of Jersey Trusts

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In a recent decision[1] the Royal Court has again considered the extent of the relief available under the doctrine of mistake in Jersey trust law in circumstances where the mistake has led to adverse tax consequences for settlors.

Since the enactment of the Trust (Amendment No 6) (Jersey) Law 2013, by which Jersey introduced a statutory basis for mistake in the form of Article 47E of the Trusts (Jersey) Law 1984 (the **Law**), there have been a number of decisions of the Royal Court in this area. However, those have been decided on the basis of the pre-existing law[2]. Whilst the Court (for example in *In the Matter of the Strathmullen Trust*[3] the subject of our earlier briefing and *The Representation of the Robinson Annuity Investment Trust*[4]) had previously considered the potential application of Article 47E, the decision in the *Great Escape Trust* has taken the analysis further forward.

Facts

The facts concerning the S and T Trusts (the **Trusts**) can be summarised as follows. The respective settlors of the trusts had settled the trusts on the basis of advice from an English financial advisor with a principal aim of avoiding UK inheritance tax in respect of English properties. The scheme as recommended to the settlors involved funds being borrowed to repay existing mortgages on the English properties and the balance invested into gilts and other assets to be held in the Jersey trusts. The lending was secured on the English property and also by way of guarantees from the trustees, and was repayable only upon the settlors' death. In fact, rather than avoiding inheritance tax, the scheme lead to significant inheritance tax charges including an immediate 20% charge, rendering the property subject to 10 yearly charges and potentially leaving the settlors with a deemed entitlement to the trust assets so as to bring those assets within their estates on death.

Issues and decision

The Royal Court deliberated for close to 9 months before giving its judgment. Whether or not to

grant the relief sought was clearly a matter of striking a careful balance for the Court but ultimately it decided to do so. The points of particular interest that arise from the decision in terms of the approach to applications of this kind are as follows.

1. There was a period of time between the settlement of the Trusts and the disposition of the assets into the Trusts. The Royal Court will typically adopt what it described as a "realistic" approach and, when considering applications to set aside a trust on the basis of a mistake (under Article 11 of the Law) will treat the establishment of a trust and the separate disposition of assets onto the trust in the round. However, where there is a more significant distance between the two transfers, the provisions of Article 47E will be relevant.

2. The first two limbs of the test for mistake are the same whether under the pre-existing law or Article 47E.

3. The third limb of the test for mistake as established in the Jersey case law and as provided in Article 47E is inverted, in as much as the case law test incorporates the question whether it is unjust on the part of the donee (the trustee recipient) to retain the settled property, whereas under the statute the test is whether it is just for the Court to make a declaration. The Court considered the margins of this difference to be *very fine* but noted that, depending upon the facts of each case, the distinction could be relevant.

4. HMRC were given notice of the proceedings and served with the Representation and, later upon request, copies of the affidavits relied upon. Although HMRC did not seek to intervene in the proceedings, they did make representations by letter to the Royal Court raising a number of legal arguments in opposition to the applications (largely based on principles arising out of the English Supreme Court's decision in *Pitt v Holt*), which were ultimately rejected. Those arguments were, in essence that: there was no actual mistake, but merely ignorance as to the tax outcome which was insufficient to ground an application; the mistake was as to consequences not the effect of the transaction; and there was nothing unconscionable in leaving the transactions uncorrected as no special circumstances existed.

5. The settlors had been involved in hard fought English litigation against the financial advisor and the bank that had loaned the money used in the scheme. This had resulted in settlement agreements being entered into by which the bank had agreed to indemnify the settlors for any UK inheritance or income tax that arose, conditional upon the settlors taking lawful steps required by the bank to reduce the tax liability. Accordingly, there was arguably no financial downside to the settlors in not being granted the relief sought in the mistake application. However, the Court noted the potential for there to be further litigation on appeal if the application failed which would inevitably add to the years of stress that the families had already endured.

The Court granted the relief sought, noting that the first two limbs of the test for mistake were unquestionably met. The Court also held that, on balance, the third limb of the test was also met

on the basis that it would be just to set aside the transfers into trust, essentially in recognition of the stress that the families had suffered and the fact that there was a likelihood of further litigation if the relief was not granted.

Comment

The balancing act that the Royal Court carried out in this case is noteworthy from a number of perspectives. Whilst it is helpful to see further consideration of Jersey's unique statutory mistake jurisdiction, there is a prospect of there being different legal tests depending upon whether an application is brought under the old (Article 11, *Lochmore Trust*) law or Article 47. It is interesting to note that HMRC took a step closer to becoming involved in a Jersey case, albeit limiting their submissions to writing. Having said that, the Royal Court was also mindful of its role and noting that *there is something unattractive* about it coming *to the rescue* of overseas tax payers seeking to avoid tax through schemes such as those in this case - the Court will have only *limited sympathy for those people who later find things have not worked out quite as they had planned*. The Court did, however, demonstrate the extent of the considerations it will take account of and, therefore, even where there was a lack of financial impact (given the indemnities agreed with the bank) it was prepared to find that justice (or lack of injustice) lay with setting aside the transfers and holding that the funds were held on bare trust for the settlors.

1 [2015] JRC259

2 Article 11 of the Trusts (Jersey) Law 1984 and the line of cases including In the matter of the Lochmore Trust [2010] JRC068

3 [2014] JRC056

4 [2014] JRC133

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