

Foundations and grounds for mistake: significant new judgment in Jersey

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Summary

In its recent decision in the case of *B and C v D, E, F and others* [2020] JRC 169, the Royal Court of Jersey (the **Court**) has considered whether a Jersey law foundation and endowments made to such a foundation can be set aside *ab initio* on the grounds of mistake. The Court concluded that although the endowments made to the foundation could be set aside, the foundation itself could not be set aside *ab initio*.

Background

The foundation was established by founders (the **Founders**) on 2 October 2012 (the **Foundation**) under the Foundations (Jersey) Law 2009 (the **Foundations Law**). Prior to the establishment of the Foundation the Founders had sought tax advice on the implications of establishing the Foundation (the **Tax Advice**). In brief summary, the Tax Advice proposed that the following steps would be taken:

1. The Founders would establish a Jersey law foundation from which they would be excluded from benefit but under which they would retain the right to demand repayment of the capital contributed (the **Founders' Rights**);
2. The Founders would transfer assets to the Foundation; and
3. The Founders' Rights would be assigned to their children.

The intention of the steps proposed by the Tax Advice was that the children would be able to demand repayment of the assets contributed to the Foundation at a later date free from taxation.

On the basis of the Tax Advice, the Founders proceeded to make a number of endowments to the Foundation during 2013 totalling £11.4 million.

Following a review of the structure in 2019, legal advice was sought which indicated that the Tax Advice was mistaken in several fundamental regards. As a consequence, the Founders and their children were found to have significant liability to HMRC in respect of unpaid taxes, interest and penalties for late payment.

The Founders and their children sought to have the Foundation set aside *ab initio* on the grounds of mistake (i.e. the Foundation would be treated as invalid from the outset so deemed never to have existed).

The Court's decision

Setting aside the Foundation:

Although Article 11 of the Trusts (Jersey) Law 1984 (as amended) (the **Trusts Law**) provides that a trust may be declared invalid to the extent that it was established by mistake, there is no express power in the Foundations Law which provides the same in respect of Jersey law foundations.

Notwithstanding this, the Founders and the Founders' children submitted that the Court could imply a power to the Foundations Law to declare that a foundation was invalid on the grounds of mistake. It was argued that Article 32(2) (a) of the Foundations Law expressly permits the Court to set aside a foundation on the grounds of lack of mental capacity and, by implication, there was therefore no reason why a foundation could not be set aside on the grounds of mistake.

However, the Court declined to set aside the Foundation and clearly identified its rationale for doing so.

Once foundation incorporated – conclusive evidence of existence:

First, the Court found that there were substantial arguments against implying a power in the Foundations Law to permit the Court to set aside the Foundation. In particular, the Court considered that there is a strong public interest in third parties being able to rely on the register of foundations as evidence of their existence. In particular, Article 29(3) of the Foundations Law specifically provides that an entry in the register of the name of a foundation is conclusive evidence that the foundation is incorporated under the Foundations Law.

Second, the Foundations (Winding up) (Jersey) Regulations 2009 provides the Court with the power to wind up a foundation on just and equitable grounds. It was considered by the Court that the availability of this power under existing statute undermined the argument that it was necessary for them to imply a power into the Foundations Law for the Court to set aside a foundation.

In contrast to a trust, a foundation is a legal entity:

Third, although the Trusts Law provides powers to set aside a trust in similar circumstances, the case of a foundation was distinguished from a trust on the basis that a trust is not a legal entity and the trustee does not hold both the legal and beneficial title to the assets it holds. In contrast, a foundation is considered a legal entity which owns the assets it holds both legally and beneficially. The Court highlighted that if they were to set aside the Foundation *ab initio* then there would be no entity able to transfer the assets back to the Founders. Further, the Court considered that, if the Foundation was set aside *ab initio*, it could be argued that the assets may revert to the Crown *bona vacantia*.

It was concluded by the Court that it had no power to set aside a foundation under the Foundations Law and that no power to do so should be implied into the Foundations Law. Therefore, the Court declined to set aside the Foundation *ab initio*.

Setting aside the endowments:

Regarding the endowment of the Foundation, the Court noted that they did have power to set aside voluntary dispositions on the grounds of mistake. Considering the facts, the Court found that the Founders were not aware of the tax consequences of the establishment and subsequent endowment of the Foundation. In considering whether to exercise their power to set aside the endowments the Court applied the three stage test set out in the case of *In the matter of the Lochmore Trust* as follows:

1. Was there a mistake on the part of the donor?
2. Would the donor not have entered into the transaction "*but for*" the mistake?
3. Was the mistake of so serious a character as to render it unjust on the part of the donor to retain the property?

The Court found that the test was met in this case and set aside as void each of the endowments made by the Founders.

Discussion

The judgment of the Court will be of particular comfort to third parties considering entering into contractual arrangements with Jersey law foundations. The Court was clear that, once established, a foundation is considered a distinct legal entity under Jersey law and cannot be declared void. It is simply not within the Court's powers to set aside an incorporated foundation *ab initio*. This brings the treatment of a foundation into line with the treatment of a corporate entity in this regard and is a welcome addition to the case law concerning Jersey law foundations.

The judgment therefore provides third parties with greater certainty when contracting with foundations.

On the flip side founders will welcome the Court's confirmation that endowments or gifts made to a Jersey law foundation may be set aside on the grounds of mistake if there are grounds, as a matter of fact, for the same.

In our view the judgment was right on both key issues.

Applicability to Guernsey foundations

The similarity of the Foundations (Guernsey) Law, 2012 (the **Guernsey Law**) to the Foundations Law is evident in the key issues raised in this case:

1. Guernsey foundations are separate legal entities in respect of which the issue by the Guernsey Registrar of Foundations of a registration certificate is conclusive evidence that the foundation is duly registered; and
2. The ability of the Royal Court of Guernsey to wind-up a Guernsey foundation is expressly set out in the Guernsey Law.

Furthermore, under Guernsey law, the Royal Court of Guernsey would similarly be able to set aside an endowment to a foundation on the grounds of mistake if the facts so permitted.

On the basis that Jersey law judgments are highly persuasive in the Guernsey courts and given the similarities between the relevant laws highlighted above, in our view the clarification of the issues addressed in this case would likely apply equally to Guernsey foundations.

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