Mistakes happen: How can they be remedied in Guernsey?

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Everybody makes mistakes.

However, when those mistakes occur in a trust context the financial consequences can be significant. This is predominantly the case when the mistakes relate to tax, and there have been a number of cases in various jurisdictions where applicants have sought reversal or rectification of mistakes (either through invoking the doctrine of mistake, or what is commonly called the rule in *Hastings Bass*), with varying degrees of success.

The doctrine of mistake is usually invoked in circumstances where a settlor has made a disposition into trust which has had unexpected consequences, whilst the rule in *Hastings Bass* tends to be invoked when a trustee has made an error in its conduct of the trust. This briefing note focuses on the doctrine of mistake.

Commonly, such applications seek the setting aside of certain transfers or dispositions of assets into a trust which have given rise to unintended tax consequences. If the transfers are set aside by the Court, the adverse tax consequences are similarly extinguished.

The Royal Court of Guernsey regularly hears these types of applications, but it is important for trustees and both legal and tax practitioners to recognise that whilst there are similarities in approach to other offshore jurisdictions, the doctrine of mistake and its application in Guernsey differs in certain respects to that which is applied in, for example, Jersey.

If you missed our analysis of the mistake regime in Jersey, please read here.

Basis of Remedy

The key principles on which a party may seek the setting aside of a transfer or disposition for reason of mistake in Guernsey are set out in the well-known English Supreme Court case of *Pitt v Holt*[1].

Unlike Jersey and Bermuda, Guernsey has not enacted legislation to provide for special rules to apply to *Hastings Bass* and/or mistake claims. Rather, the Royal Court of Guernsey has expressly adopted the principles laid down by Lord Walker in *Pitt v Holt*.

Broadly, those principles require:

1. that there must be a mistake, which is more than mere ignorance, inadvertence or mis-prediction;
2. the mistake must be sufficiently grave as to make it unconscionable on the part of the trustee to retain the property; and
3. the Court to consider objectively the injustice, unfairness or unconscionableness of leaving the mistake uncorrected in the round – the judgment is an evaluative one.

In relation to the second limb of the test, a sufficiently grave mistake is usually established by showing that the mistake is basic to the transaction. In assessing this, the Court will consider the gravity of the mistake with reference to the circumstances of it, and the consequences for the person who made it (and any other interested persons).

Recent Cases

The principles above have been applied in a number of recent cases in the Royal Court of Guernsey. Some of the most interesting and significant are summarised below:

Whittaker v Concept Fiduciaries Limited[2]

A business owner transferred her shares into a "*fundamentally flawed*" tax-planning structure, which contrary to an intention to secure tax advantages for the business owner and her heirs, would actually have had disastrous tax implications if left uncorrected.

The Royal Court set aside that transaction and, importantly, drew a distinction between "*artificial tax avoidance transactions*" (which may justify refusal to grant the relief) and the arrangement in this case.

In the matter of the B Trust[3]

In this very recent case, in which Collas Crill LLP acted for the successful applicant, the settlor of the B Trust made a number of transfers of UK situs funds into a Guernsey trust between 2000 and 2010. His motivation for doing so was to provide for his immediate family's needs after his death. He was advised and believed that no tax charges would arise as a result. Contrary to this belief, a substantial UK inheritance tax charge arose which amounted to over 55% of the value of the trust fund as at the time of the application.

Unusually, the application was brought many years after the initial disposition into trust because the tax charge was only appreciated when the trustee sought to retire in 2017. The Royal Court set aside the transactions, agreeing with the settlor's position that it would be unconscionable for dispositions to stand, which would have meant that the inadvertent tax charges would wipe out approximately half of the trust fund.

Following the *Whittaker* case (set out above), the applicant was also clear to confirm that this was far removed from a case of artificial tax avoidance which had gone wrong.

Other instances of mistake

In addition to the above, the principles of the doctrine of mistake have also been applied by the Royal Court of Guernsey in situations where:

1. a disposition was made into a trust when it was clear the settlor had not sufficiently understood it (*Dervan v Concept Fiduciaries Ltd[4]*);

2. a transfer of shares was made into a trust, when not only did the settlor not understand the trust to which he was transferring the shares, but it was also clear that he was unaware of the tax effects of doing so (*Nourse v Heritage Trustees Limited[5]*); and

3. an appointment by trustees to a recipient caused (contrary to what the recipient thought) a tax charge of 40% (the Court refused to set aside the appointment, finding that it would not be unconscionable for the recipient to keep the proceeds)

(*Gresh v RBC Trust Company*[6]).

Analysis

The doctrine of mistake continues to offer applicants an effective avenue by which mistaken dispositions into trust and the inadvertent consequences of those mistakes may be rectified, sometimes even many years after the dispositions in question.

However, practitioners should be aware of the differing stance that Guernsey has taken to these applications when compared with other offshore jurisdictions - the position in Guernsey is fully in line with that of England and Wales.

Of significance to potential applicants in Guernsey, is the relationship between a successful application and what has been termed 'artificial tax avoidance'. If possible, applicants would be wise to continue to demonstrate that, although adverse tax consequences may have occurred, the transaction in question is not one which brings it within the scope of the aggressive tax planning and avoidance which has received such disapproving comment from the judiciary in recent cases.

Ultimately, mistake cases are usually very fact sensitive. If we can be of assistance where unexpected consequences have become apparent as a result of a mistake, please contact us to see how we can help.

[1] Full citation: *Pitt v Holt; Futter v Futter* [2013] 2 AC 108
[2] Guernsey Judgment 15/2017
[3] The full reasoned judgment has not yet been published
[4] Guernsey Judgment 4/2013
[5] Guernsey Judgment 1/2015
[6] Guernsey Judgment 6/2016

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