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Royal Court of Jersey declines to grant application to correct trustee's mistake and permit partial rescission

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Case analysis by Group Partner Sam Williams, Of Counsel Fritha Ford and Associate Kirsten Bailey, published on LexisPSL on 8 July 2021

Private Client analysis: The trustee of the M Settlement, a Jersey law trust, applied to the court pursuant to Article 47G of the Trusts (Jersey) Law 1984 to set aside part of a transaction entered into by the former trustee (the Former Trustee) due to a mistake, on the basis that it had failed to appreciate that there would be a resulting inheritance tax (IHT) charge several years later. In this case, it was argued that the court should set aside only those parts of the transaction which had given rise to the adverse IHT charge, namely a share sale agreement and a loan back agreement, while leaving intact the transfer of ownership of the shares to a wholly owned company as a gift. Written by Sam Williams, Group partner, Fritha Ford, of counsel, and Kirsten Bailey, associate, at Collas Crill Jersey.

While the Royal Court accepted that Article 47G provides for a flexible remedy, allowing the court to determine the extent to which a voidable power has effect, it held that this did not give the court the power to rewrite history and substitute a different transaction from that which the parties entered into.

This case is a timely reminder to practitioners that mistake remedies are not without limitation, even in circumstances which on their face appear similar to transactions that have been set aside before.

Representation of Hawksford Trustees Jersey Ltd in re the M Settlement [2021] JRC 130

What are the practical implications of this case?

Article 47G of the Trusts (Jersey) Law 1984 (as amended) provides that where a trustee or other power holder has made a sufficiently serious mistake in relation to the exercise of that power and, but for the mistake either would not have exercised that power or would have exercised it in a different way, the court may declare the exercise of that power voidable, either so that it has no effect at all from the time of its exercise or so that it has such effect as the court may determine. In the Matter of the M Settlement is the first time that the court has considered the nature of that remedy in the context of partial rescission.

The transaction in question had been structured as a sale, which, due to the Settlor's deemed UK domicile, led to an IHT liability of approximately £500,000. In order to extinguish this liability, the court was asked to alter

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the nature of the transaction such that the sale would be deemed to have taken place as a gift; however, the court declined to do so, leaving the Settlor with a significant IHT liability and the only solution to this being a negligence claim against the chartered accountants engaged by the Former Trustee.

This decision highlights the importance of taking comprehensive tax advice in relation to each transaction and the risks to trustees in failing to do so—the advice sought by the Former Trustee appeared to have been taken largely after the core decisions had been made and failed to address IHT issues.

What was the background?

The M Settlement held, through a nominee, a 90% interest in a Jersey registered company known as N Ltd. The other 10% was held by an unrelated trust, the C Trust.

In or around 2011, a beneficiary of the C Trust requested a loan, which required monies to be moved up from N Ltd. While the M Settlement had no such need, in order to facilitate the loan, the Former Trustee engaged in restructuring and sought advice from a firm of chartered accountants; however, it appears that no consideration was given to the IHT consequences of the transaction, despite the Settlor being deemed domiciled in the UK, rendering the trust subject to a IHT ten-year charge.

Relying on the professional advice received, the Former Trustee established a new holding company, P Ltd, and sold to it its 90% shareholding in N Ltd. The purchase price of $US 18.9m was notionally paid on a deferred basis by way of a loan-back agreement. At the direction of the Former Trustee, a nominee declared a trust over the shares in N Ltd in favour of P Ltd. Subsequently, in order to move monies up to the trust, P Ltd sold 95% of its shareholding back to N Ltd, taking the benefit of a loan receivable in respect of the purchase price of $US 20.3m. Similar steps were taken in relation to C Trust.

Nine years later, in preparing the requisite IHT return in respect of the IHT ten-yearly charge, the issue with the transaction came to light. The current trustee applied to the court for a declaration that the sale of the 90% shareholding in N Ltd to P Ltd and the loan-back agreement be set aside on grounds of mistake and the shares be deemed to have transferred by way of gift. Had the shares been gifted, no IHT charge would have arisen.

What did the court decide?

While noting that the question of whether or not the court had the power to give partial effect to the transaction was finely balanced, the court ultimately decided against substituting a sale with a gift.

It was clear that the Former Trustee had made a mistake and that, but for that mistake, the transaction would have been structured and the relevant powers exercised in a different way. The whole transaction including the transfer of shares to P Ltd was therefore liable to be set aside. However, this would have impacted the unrelated C Trust (which held the other 10% of the shares in N Ltd) and would have given rise to further adverse tax consequences for the trust.

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The court acknowledged the flexible nature of the remedy under Article 47G of the Trusts (Jersey) Law 1984, but stated that, in its view, while the court may have a discretion to determine the extent to which the sale transaction is given effect, it could not substitute an entirely different exercise of a power for that which was undertaken. Critically, the relevant power to be set aside here was the trustee's administrative power of sale, upon which the disposition of ownership was merely consequential and not a freestanding or severable exercise of a power. Further, the court noted that there was no legal distinction or different standard to be applied simply because the transaction was notionally an internal one to the trust structure.

Case details

- Court: Royal Court of Jersey
- Judges: Commissioner Clyde-Smith OBE and Jurats Olsen and Ronge
- Date of judgment: 4 May 2021

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