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Another attempt to re-write history: the limits of Jersey's remedies for mistake

Service area / Dispute Resolution and Litigation, Trusts and Private Wealth
Legal jurisdictions / Jersey
Date / August 2021

Representation of Hawksford Trustees Jersey Limited in the matter of the M Settlement
Royal Court of Jersey (J.A. Clyde-Smith, Commissioner, and Jurats Olsen and Ronge) 4 May 2021
Court of Appeal of Jersey (Bompas QC, Mountfield QC and Storey QC) 6 August 2021

Last year, we reported on the important decision of the Royal Court of Jersey in April 2020 in *Re Grundy* [2020] JRC 071, which case our firm presented to the Royal Court and which demonstrated the flexibility of the remedies available under Jersey law where a successful application to set aside the exercise of a fiduciary power on grounds of mistake and/or inadequate deliberation is made (No re-writing history: the flexibility of Jersey's remedies for mistake and inadequate deliberation). Importantly, however, the Court in that case emphasised that there were limits to that flexibility and that the Court could not *"re-write history"* when dealing with a mistake application.

Now, in the *M Settlement* case, the Royal Court has refused relief as it considered it was being asked to do exactly that, by "*substituting a different transaction for that which was undertaken*". The Royal Court's refusal of relief was upheld on appeal to the Court of Appeal of Jersey, this being a rare example of an appeal in a mistake case in this jurisdiction. The case therefore provides a helpful and authoritative confirmation of the limits of the flexibility of the remedies available in Jersey.

Background

The current trustee (the "**Trustee**") of the M Trust, a Jersey law discretionary trust, applied to the Royal Court under Article 47G of the consideration of the mistake provisions of the Trusts (Jersey) Law 1984 ("**Trusts Law**") to set aside part of a transaction entered into by the former trustee of the M Trust (the "**Former Trustee**") on grounds of mistake.

Background to the transaction

The M Trust held (through a nominee (the "**Nominee**")) a 90% shareholding in a Jersey registered company called N Limited. The remaining 10% shareholding in N Limited was held by a separate trust known as the C Trust.

In or around 2011, a beneficiary of the C Trust sought to borrow money from the C Trust which created the need to move money up from N Limited so that it could be lent to that beneficiary. The M Trust had no need for money to be moved up from N Limited. The intention was to devise a tax efficient transaction which would allow cash to be provided to the C Trust, while retaining the proportionate ownership of N Limited by the trust.

The Transaction – steps taken by the Former Trustee

The Former Trustee had obtained tax advice from a firm of chartered accountants in December 2011 and January 2012 in connection with the proposed transaction. Following its receipt of the tax advice, the Former Trustee took steps to enable the movement of money from N Limited to the C Trust as follows:

1. The Former Trustee established a new holding company, referred to in the judgment as P Limited;
2. A sale and purchase agreement was entered into between the Former Trustee and P Limited on 12 March 2012 for the sale of the M Trust's 90% shareholding in N Limited to P Limited for a purchase consideration of US$18.9 million (the "**P SPA**");
3. On the same day,

a. A loan agreement was entered into between the Former Trustee and P Limited to document that the sale consideration had been left outstanding in the amount of US $18.9 million (the "**P Loan Agreement**");

b. a direction was given by the Former Trustee to the Nominee to hold the shareholding in N Limited for P Limited (the "**Nominee Direction**"); and

c. pursuant to that direction, the Nominee executed a new declaration of trust which provided that it held the 90% shareholding in N Limited for P Limited (the "**New Declaration of Trust**");

(together, the "**Transaction**").

The C Trust took similar steps on or around the same date, through a new holding company referred to in the judgment as Y Limited. The movement of funds from N Limited was subsequently achieved by N Limited buying back shares from P Limited and Y Limited. In the case of Y Limited, the buyback consideration was paid as cash, whereas for P Limited it was left outstanding as a debt due.

Consequences of the Transaction

In or around 2019, the Trustee engaged a tax accounting firm to prepare the UK Inheritance Tax return for in respect of the M Trust which arose on 19 June 2019, that being the tenth anniversary of the settlement of the M Trust. It transpired that, although the shares in P Limited which were held by the M Trust qualified for business property relief at the 100% rate, the loan due from P Limited to the M Trust under the P Loan Agreement did not. This receivable, net of other receivables due to P Limited from the M Trust, equated to £11.2 million on which IHT was chargeable (subject to certain deductions) in an amount of just over £500,000.

The IHT charge of c.£500,000 would not have arisen had the P SPA and the P Loan Agreement not been entered into, and had the Transaction instead proceeded by way of the Nominee Direction and the New Declaration of Trust alone. In other words, the IHT charge would not have arisen if the Former Trustee had simply transferred the shares in N Limited to P Limited by way of gift as opposed to sale.

The application to set aside the transaction in part only

An application was made by the Trustee in July 2020 whereby the Trustee sought declarations from the Royal Court that: (i) the P SPA and the P Loan Agreement each be set aside on the grounds of mistake pursuant to Article 47G of the Trusts Law and be of no effect from the date of those respective agreements; and (ii) the Nominee Direction or the New Declaration of Trust would continue to have effect.

The Royal Court's decision

The application came before the Royal Court for its first substantive hearing on 25 September 2020. At that hearing, the Court indicated that it had concerns in respect of the request made of it to set aside two parts of a composite transaction, specifically the P SPA and the P Loan Agreement, rather than the whole of the Transaction. The Court adjourned the application so that the Trustee could obtain advice on the tax implications of setting aside all four parts of the Transaction.

Professional tax advice was subsequently received by the Trustee to the effect that setting aside all four parts of the Transaction would serve to further increase the IHT liabilities of the Trust. It therefore appeared that the only solution available to the Trustee (aside from issuing a negligence claim against the original tax advisors, if possible) was to obtain an order from the Royal Court that only the two relevant parts of the Transaction be set aside. The key issue before the Court was whether it had the power to make such an order under Article 47G of the Trusts Law.

The requirements of Article 47G were satisfied

The Royal Court accepted that: (i) the Former Trustee had been "*clearly mistaken*" as to the IHT consequences that would arise as a consequence of the Transaction; and (ii) the Former Trustee would not have exercised its power to enter into the Transaction in the manner that it did (i.e. by transferring the shares by way of a sale as opposed to a gift) had it not been for that mistake. It was also accepted that the liability for the IHT charge was of a sufficiently serious character so as to render it just for the Court to make a declaration under Article 47G of the Trusts Law. The Court therefore found that the requirements of Article 47G(3) of the Trusts Law had been met.

The Court of Appeal considered that the evidence in support of these matters was slight. However, as it had no appeal before it against the Royal Court's finding on these points and it had not heard argument, it proceeded on the basis the requirements were satisfied.

The Royal Court also acknowledged that Article 47G(2) provides the Court with a "*flexible remedy allowing it to determine the extent to which a voidable exercise of power has effect*". However – was that flexibility capable of being extended to as to enable the Court to grant the orders for partial rescission of the Transaction which were sought by the Trustee?

No ability to re-write history – In Re Grundy distinguished by the Royal Court

As already noted, the Royal Court ultimately rejected the Trustee's application.

Although it said that the arguments for and against the making of the orders sought by the Trustee were "*finely balanced*", the Court was not persuaded that the circumstances of the case enabled the Court under Article 47G(2)(a) to "*effectively substitute a different transaction from that which the parties entered into*". In reaching that conclusion, the Court held that "*it may have the power to determine the extent to which the sale transaction is given effect to, but not to the point where it is transformed into a different transaction; namely where it ceases to be a sale and becomes a gift. To do so would be to rewrite history by substituting a different transaction for that which was undertaken.*"

Re Grundy [2020] JRC 071 was distinguished on the basis that the power exercised by the former trustee in that case was a

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power of exclusion of a beneficiary and the exercise of that power remained to exclude the beneficiary, although the duration of the exclusion was limited by the Court. Conversely, the Trustee in the present case had determined to sell the shares in N Limited, and was effectively requesting that the Court substitute for that sale a different exercise of power (i.e. a gift). The Court held that there was a "*material difference*" between: (i) determining the effect that an exercise of a power may have; and (ii) changing the nature of the power being exercised.

Court of Appeal refused to overturn the Royal Court's decision

The Court of Appeal held that Art 47G does not allow the Court to reform the transfer, disposition or exercise so that it becomes a new and different one from which has been made voidable. The statute allows the voidable matter to have "such effect as the court may determine", which must mean preserving, or allowing to survive, some aspect of what is otherwise declared voidable. To set aside the P SPA and the P Loan Agreement while leaving the transfer of title in the N Limited shares undisturbed went beyond partial avoidance of the Transaction taken as a whole, it was to re-characterise it into a different transaction entirely.

Further, even if that difficulty could be overcome, the Court of Appeal also observed that ordinarily where the sale of a property is set aside, the property which had been transferred through that avoided sale will be held for the transferor (the Court of Appeal suggested on resulting trust). No authority had been provided to the Court to substantiate an argument that where the transferee is a company wholly owned by the transferor trust the correct inference was of a beneficial disposition of interest in favour of the company. Instead, the Court considered that where there is a transfer from a trustee to an underlying company of the trust, whether such transfer is intended to be by way of sale or by way of gift must be determined from all the relevant circumstances, here the transaction documents. It was clear from those documents and the resolutions made by the Former Trustee that a sale rather than a beneficial disposition was intended. Therefore, if the sale were to be avoided, the shares would have been held for the Trustee rather than for P Limited beneficially.

Finally, the Court also rejected an argument, made for the first time on appeal, that it could reduce the sale price under the P SPA and the amount of the loan under the P Loan Agreement to a level that would avoid the IHT charge. It characterised this as an attempt to rectify these documents, without there being any suggestion that such reduced price was intended by the parties at the time the Transaction was entered into.

Comment

The Court's powers to set aside transactions on grounds of mistake or to allow them to have such effect as the Court determines are powerful remedies capable of responding to instances of great difficulty that arise in connection with a Jersey trust. However, there are strict doctrinal and statutory limits to the jurisdiction that have been developed and explained in these and other cases. The circumstances of any particular case must therefore be considered carefully to understand the extent of the remedies that may be available.

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