‘But I didn’t mean to!’

Recent cases on mistake and intention

Constance McDonnell
Serle Court

Carlos de Serpa Pimentel
Appleby, Cayman

serle court APPLEBY

‘*But I didn’t mean to!*’

- Equitable jurisdiction of mistake re voluntary transactions
- Rectification of written instruments
- Application of rule in *Hastings-Bass* where effect of Trustees’ actions is different to what they intended

Foreword

- ***JF & MF v Hexagon Investments Ltd***, Cayman, Oct 2014
  - Prior to making any application based on mistake, plaintiffs sought declaration as to whether beneficial title to assets of investment portfolios had been transferred to trustee of Hexagon Settlement
  - Evidence as to plaintiffs' states of mind and their intentions in entering into the relevant transactions was of '*fundamental importance*' to the application as capacity in which trustee received transfers of assets from them would depend on plaintiffs' intentions when directing those transfers

Foreword (2)

- Question of whether beneficial title had passed turned on whether conscience of trustee was affected in such a way that it must be declared as holding the portfolios on trust either for plaintiffs or on trusts of settlement or for itself beneficially
- Very detailed analysis of all documents leading up to each transaction: emails, minutes etc, as well as '*extensive*' affidavit evidence re plaintiffs' understanding and intention at the time
- '*ongoing state of confusion*' in lawyer's mind in relation to key aspects of transactions

Foreword (3)

Judgment:

–Trustee did not take positive step of resolving formally to accept transfers of assets

–Therefore portfolios never became vested in trustee in capacity as trustee

–Instead, corporate trustee received assets as beneficial owner itself (as intended by plaintiffs)

–Existence of settlement '*doubtful*' as no assets settled upon it

–No need to resort to resulting trust principles

Mistake (1)

- ***Schroder Cayman Bank and Trust Co Ltd v Schroder Trust AG***, Cayman Islands, March 2015
  - Purported appointment to benefit a class of beneficiaries under employee-financed retirement benefit schemes (EFRBSs)
  - Class of beneficiaries of recipient EFRBSs was wider than under donor (Cayman) employee benefit trust set up by UK company
  - Cayman trustee received incorrect advice as to tax-efficiency of appointment to EFRBSs in Jersey, and funds in those schemes were liable to inheritance tax in UK

- ***Schroder Cayman Bank and Trust Co Ltd v Schroder Trust AG*** (cont'd)
  - Appointments void as class of beneficiaries of EFRBSs was wider than under donor trust
  - Alternatively, would be set aside on ground of mistake as:
    - Trustees of donor trust intended to benefit only persons who were beneficiaries of donor trust
    - UK tax charge was '*extremely undesirable and deleterious to the Fund*' and therefore not in beneficiaries' best interests
    - Clear that trustees wished to effect appointments which were revocable in case assets had to be returned to fund any tax liability
  - Therefore '*severe consequences*' were never intended, and unconscionable to leave mistakes uncorrected

Mistake (2)

- ***Gresh v RBC Trust Co (Guernsey) Ltd***, Guernsey, February 2016
  - Application to set aside distribution of lump sum from pension fund, which recipient (G) had been advised would be tax-free. In fact, G was assessed at 40% tax. [Original application under rule in *Hastings-Bass* withdrawn and reformulated as one based on equitable jurisdiction of mistake following *Pitt v Holt*.]
  - HMRC intervened [after separate legal battle]
  - Held: no reason why principles in *Pitt v Holt* should not be applied in Guernsey

Gresh v RBC Trust Co (Guernsey) Ltd (cont'd)

- Noted that no suggest that G was seeking to contrive an artificial tax avoidance scheme, but simply made causative mistake in requesting distribution as result of misleading advice as to tax consequences

- However, it would not be unconscionable to leave G's mistake uncorrected as the only person affected would be G (and HMRC) [cf. in other cases where court has set aside disposition on ground of mistake, there have been other parties whose interests were affected]

- '*It is not every serious error that will be corrected by the courts*'

- Court unaware of whether G would be able to recover damages from advisors on basis of professional negligence

Footnote to *Gresh*

- ***In the matter of the S Trust and in the matter of the T Trust***, Jersey, December 2015
  - Similar facts to *Gresh* – i.e. applications to set aside transfers of money into trusts on the basis of mistake as to tax consequences
  - Jurisdiction under Jersey legislation (pre-Oct 2013: Article 11 of Trusts (Jersey) Law 1984; post-Oct 2013: Article 47Aff. Trusts (Amendment No. 6) (Jersey) Law 2013)
  - Royal Court had '*utmost respect*' for *Pitt v Holt* but it was not binding
  - Royal Court would '*by a small margin*' set aside transfers apparently on basis of stress Representors would otherwise experience if such orders not made (and effect such stress would have upon their children's upbringing)

Mistake (3)

- ***Van Der Merwe v Goldman***, England & Wales, April 2016
  - Husband and wife transferred house in Oxford into H's sole name, and H then transferred into interest in possession settlement on basis of advice would avoid tax liability (only days after such a settlement in fact became chargeable transfer for value)
  - Morgan J considered that resulting trust principles applied
  - H&W had both made relevant mistake when transferred house and when H settled house on trust, and mistake sufficiently grave to satisfy *Pitt v Holt* test

Mistake (4)

- ***Whittaker v Concept Fiduciaries Ltd***, Guernsey, March 2017
  - Applicant transferred company shares into remuneration trusts on basis of incorrect advice that would avoid CGT and IHT
  - Noted that '*nothing intrinsically artificial*' about the remuneration trust arrangements
  - Transfers would be set aside on grounds of mistake. Mistake was '*distinct*', '*causative*' and '*grave*'
  - Applicant's children and grandchildren would be affected as would not be able to benefit from capital distributions

Foreword on rectification

- Possible reluctance to exercise discretion to rectify where the relevant scheme can be categorised as '*aggressive tax avoidance*'
  - *'[it] seems to us perhaps to be open to argument .. whether .. there is room for the argument that the discretion ought not to be exercised if on the facts of a particular case, the scheme in question is lawful but appears to be so contrived and artificial that it leaves the Court with distaste if, in effect, it is required to endorse it'* – ***IFM Corporate Trustees Ltd v Helliwell***, Jersey, July 2015

Rectification (1)

- ***Girls' Day School Trust v GDST Pension Trustees Ltd***, England & Wales, May 2016
  - Application for summary judgment in claim to rectify pension scheme deed
  - Claimant had to establish by '*cogent evidence*' that it and trustee had a '*common, continuing, objectively established intention*' which by mistake was incorporated into, omitted from or otherwise not correctly reflected in deed in present form
  - Judge satisfied that no real prospect of challenge to evidence as to intention <u>but</u> there would have to be unrestricted access to all evidence which should be open to inspection on court file, scheme members to be informed, and rectification not to take effect for 42 days

Rectification (2)

- ***Re H and J Trusts***, Jersey, December 2016
  - Application to rectify identical deeds establishing two trusts to resolve ambiguity as to construction of 'settlor' as excluded beneficiary
  - Rectification would be granted as good ongoing administration of trusts requires that construction not be left open to future challenges
  - **But** Court not persuaded to rectify deeds so as to add power to amend dispositive or administrative provisions:
    - No evidence that consideration given to these when trusts established
    - Power to amend dispositive provisions would be unusual, and absence of power to amend administrative provisions did not make trusts '*unfit for purpose*', so omission of both powers not '*genuine mistake*'
    - Adjourned for further affidavit evidence with '*far fuller explanation*' why powers required

Rectification (3)

- ***RBC Trustees (CI) Ltd v Stubbs***, England & Wales, February 2017
  - Application for rectification or rescission of two deeds of revocation and appointment
  - On consideration of all (detailed) evidence on trustees' and solicitors' files: trustees intended (and were instructed to) only to revoke one beneficiary's interest, rather than to revoke and re-appoint another beneficiary's interest (which created '*catastrophic*' tax liabilities post-Finance Act)
  - HMRC did not take part, but contrary arguments put on behalf of settlor (despite fact she supported claim) for benefit of court

RBC Trustees (CI) Ltd v Stubbs (cont'd)

- *Day v Day* (2014) applied – Court had to evaluate quality of evidence carefully
- There was 'flaw' in deeds because nature of changes they made to trust arrangements were not intended, wanted or needed
  - Rejected argument that net effect of changes actually did accomplish what settlor wanted, i.e. removal of 1 beneficiary, and therefore only consequence was fiscal which would be insufficient
  - Recognised that parties would probably not have sought rectification had changes not had tax consequences
  - Mistake was independent of tax consequences
  - There was issue capable of being contested (as required: see e.g. *Racal*), namely question of which deed creates interests of remaining beneficiaries and their children (different rules might apply depending on date of deed)
- Deeds would be rectified

Rectification (4)

- ***Church Bay Trust Co Ltd v HM A-G for Bermuda***, Bermuda, May 2017
  - Unopposed application to rectify settlement so as to extend power to add/exclude beneficiaries to period after settlor's death, not merely his lifetime
  - Quality of evidence as to settlor's intention was '*very high*' as derived from period prior to execution of deed and was based upon communications between settlor and trustees
  - '*Quite clear*' that settlor intended that beneficiaries could be added after his death, so rectification would be granted

A footnote re the survival of the rule in *Hastings-Bass*

- The rule is now enshrined in legislation in Jersey and Bermuda:
  - Jersey: Articles 47F and 47H of the Trusts (Jersey) Law 1984 (with effect from 25 October 2013)
    - Applied in *Re Z Trust* (Feb 2016)
  - Bermuda: section 47A of the (Bermuda) Trustee Act 1975 (with effect from 29 July 2014)
    - Applied in *Re F Trust* (November 2015)

A footnote re the survival of the rule in *Hastings-Bass* (2)

- *Power Adhesives Ltd v Sweeney* (England & Wales, March 2017)
  - Rule in *Hastings-Bass* invoked by company in application to set aside a decision by its directors to issue 490,000 B shares of £1 each (existing share capital had nominal value of only £10,000). Those shares were allotted to one director (S) to extinguish his director's loan. S had since died
  - Company and directors did not appreciate at the time that the issue and allotment of those shares to S would fundamentally alter balance of interests in the company between shareholders, and would transfer very significant proportion of company's value to S. Also potential CGT and IHT liability for S's estate
  - HMRC joined as defendant

Power Adhesives Ltd v Sweeney (cont'd)

- Claimant was substantial trading company and directors had '*considerable degree of experience and sophistication*'
- Directors did not fail to fulfil fiduciary duties in deciding in principle to swap S's director's loan for equity
- But did fail to fulfil their fiduciary duties because they failed to take into account relevant considerations such as '*massive dilution*' of value of ordinary shares and potentially very serious tax consequences for the shareholders
- AND (distinguishing the facts in *Pitt v Holt* and *Futter v Futter*) the directors had not obtained advice from the company's auditors on the basis of full and proper instructions as to how the loan/equity swap should be effected. [Such advice was mainly focused on overall family tax planning.] Decision to issue and allot shares therefore set aside