

Rescission of Voluntary Settlements and Dispositions of Trust Property on the Ground of Mistake

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A. INTRODUCTION

The English law on rescission of voluntary settlements and dispositions of trust property on the ground of mistake is governed by *Pitt v Holt*.¹ The Jersey law is governed by the Trusts (Jersey) Law 1984, as amended by the Trusts (Amendment No 6) (Jersey) Law 2013. This article will review English and Jersey law in turn, considering their history and content and the ways in which they have been applied in recent cases.

B. ENGLISH LAW

(1) Prior to 2013

For twenty years the most influential statement of equity's jurisdiction to rescind voluntary settlements for mistake was Millett J's formulation in *Gibbon v Mitchell*.² He said that voluntary transactions could be rescinded for spontaneous mistake, provided that the mistake concerned 'the effect of the transaction itself and not merely ... its consequences, or the advantages to be obtained from it'. Applying this rule, he set aside a deed under which a beneficiary had purported to surrender his protected life interest in the trust capital, believing that this would accelerate his children's remainder interest into an immediate absolute interest. In fact, the effect of the purported surrender was to forfeit the beneficiary's life interest and cause discretionary trusts to spring up in favour of the beneficiary and his children under the Trustee Act 1925, s 33. Because the beneficiary's life interest was protected, he could not have achieved the desired effect by executing the deed: his proper course would have been to apply to the court for an order under the Variation of Trusts Act 1958.

Millet J said that if the beneficiary had been 'asked the narrow question whether he intended to release his protected life interest ... in favour of his children, he must have answered "Yes".' Nevertheless, his mistake had concerned the 'effect' of the surrender and not its 'consequences' because he had meant to surrender his protected life interest not 'for its own sake' but 'with the effect that the beneficial interest in the capital of the fund should forthwith vest ... in [the children]'. Judges in later cases noted that Millett J's effects / consequences distinction was conceptually unstable, since it was unclear how one should decide whether any given outcome of a transaction fell within one category or the other. However, they welcomed the flexibility that Millett J's approach gave them to keep the equitable jurisdiction within reasonable bounds and ensure that it was not exercised where parties had misconceived the commercial or taxation effects of

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¹ [2013] UKSC 26, [2013] 2 AC 108.

² [1990] 1 WLR 1304, 1309.

transactions or had knowingly run the risk that these might turn out badly.³

In *Sieff v Fox*,⁴ counsel then attacked the *Gibbon* test by arguing that it was inconsistent with Lindley LJ's much earlier finding in *Ogilvie v Littleboy*, that in the absence of suspicious circumstances:⁵

'a donor can only obtain back property which he has given away by showing that he was under some mistake of so serious a character as to render it unjust on the part of the donee to retain the property given to him.'

In *Sieff* Lloyd LJ (sitting at first instance) did not resolve the tension between this dictum and Millett J's dictum in *Gibbon*, but in other cases it was suggested that in light of *Ogilvie*, the effects / consequences test should be abandoned in favour either of a 'simple causative mistake' test akin to the common law test for restitution of mistaken payments⁶ or a 'serious causative mistake' test.⁷

(2) *Pitt v Holt*

The correct test then fell to be determined in *Pitt v Holt*.⁸ Acting as the court-appointed receiver for her incapacitated husband, Mrs Pitt executed a settlement of money paid to him pursuant to a personal injury claim. She sought to set the settlement aside when it turned out to have unforeseen IHT consequences. The first instance judge took *Gibbon* to be the governing authority, with the result that rescission was limited to cases where a mistake was made as to 'effects' rather than 'consequences'. Mrs Pitt's mistake did not qualify because the settlement had achieved what she had intended by way of legal effect and any mistake she had made had concerned the unforeseen tax consequences of the settlement; it was in any case doubtful that she had made a mistake, since she had not thought about the tax treatment of the settlement at all and had acted unreflectingly on advice.

On appeal, Lloyd LJ favoured a hybrid test that combined the *Ogilvie* and *Gibbon* tests.⁹ The claimant's mistake had to be of one of two types. In the absence of some 'additional vitiating factor', such as misrepresentation or concealment, the claimant must either have made a mistake as to 'the legal effect of the disposition' rather than its 'consequences', or a mistake as to 'an existing fact which is basic to the transaction'. It would not suffice that the transaction gave rise to unforeseen tax liabilities: this would be a 'consequence', rather than an 'effect', and so it would not bring the equitable jurisdiction into play. In addition, the mistake had to be of 'so serious a nature as to render it unjust on the part of the donee to retain the property given to him'. Lloyd LJ considered that this set a 'very high test as to the gravity of the mistake', an assessment that was borne out by his application of the

³ *AMP (UK) plc v Barker* [2001] PLR 77 [70] (Lawrence Collins J); *Anker-Petersen v Christensen* [2002] WTLR 313 [38] (Davis J); *Wolff v Wolff* [2004] WTLR 1349 [25]–[26] (Mann J).

⁴ [2005] EWHC 1312 (Ch), [2005] 1 WLR 3811.

⁵ (1897) 13 TLR 399, 400.

⁶ *Fender v National Westminster Bank plc* [2008] EWHC 2242 (Ch), [2008] 3 EGLR 80; cf *Clarkson v Barclays Private Bank & Trust (Isle of Man) Ltd* [2007] WTLR 1703.

⁷ *Re Griffiths* [2008] EWHC 118 (Ch), [2009] Ch 162; *Bhatt v Bhatt* [2009] EWHC 734 (Ch), [2009] STC 1540.

⁸ [2010] EWHC 45 (Ch), [2010] 1 WLR 1199; reversed [2011] EWCA Civ 197, [2012] Ch 132; reversed in part [2013] UKSC 26, [2013] 2 AC 108.

⁹ *Pitt* (CA) (n 8) [203] ff.

test to the facts of *Pitt*. In his view, Mrs Pitt had entered the transaction in the mistaken belief that it would have no adverse tax effects, and this mistake satisfied the *Ogilvie* test of seriousness, given that the IHT liabilities would significantly deplete the assets available to meet Mr Pitt's needs during his lifetime. However, Mrs Pitt's mistake concerned the tax treatment of the settlement and this was a 'consequence' rather than an 'effect' of the settlement. Hence rescission on the ground of mistake was not available.

On further appeal, the Supreme Court found in Mrs Pitt's favour on this issue.¹⁰ Lord Walker first considered what counts as a 'mistake' in this context. He held that a mistake as to present facts or law is needed and that a misprediction of future events is not enough. So one cannot rescind a voluntary settlement on the ground of mistake if one has executed the settlement in the expectation that something will happen in the future and it does not happen.

Lord Walker also distinguished 'incorrect conscious beliefs', 'incorrect tacit assumptions' and 'mere causative ignorance', and held that relief may be available for the first and second of these, but that 'mere ignorance, even if causative, is insufficient'. These are terms of art which require some explanation. An 'incorrect conscious belief' is held by a claimant who knows at the time of entering a transaction that he would not enter it if a certain state of affairs existed, and who consciously bases his decision to enter the transaction on an incorrect belief that this state of affairs does not exist. An 'incorrect tacit assumption' is made by a claimant who knows at the time of entering a transaction that he would not enter it if a certain state of affairs existed, and who incorrectly assumes that it does not exist. A claimant is 'causatively ignorant' if he does not know at the time of entering a transaction that his decision-making would be affected if he knew that a certain state of affairs exists, but who would not enter the transaction if he knew this information, and in fact the relevant state of affairs does exist.

Suppose, for example, that a settlor settles property on his son who has secretly married without his consent. Suppose, further, that the settlor has always been determined not to support his children financially if they marry without his consent. In this case, the settlor makes a qualifying mistake when he executes the deed of settlement, whether he has a conscious belief that his son is unmarried or merely assumes this to be true. Compare a case where a settlor settles property on his daughter who has been a member of UKIP for the past 10 years. It has never occurred to the settlor that any of his children might join UKIP and he has never considered whether the knowledge that they had done so might affect his wish to benefit them. Now that he thinks about it, he can truthfully say that he would never have gifted property to his daughter if he had known she was a UKIP supporter. In this case, the settlor does not make a qualifying mistake, although knowledge of the relevant fact would have altered his decision to benefit her.

Having established what counts as a 'mistake' for the purposes of a claim for rescission, Lord Walker went on to discuss what types of mistake should entitle a claimant to the remedy. He rejected the *Gibbon* test, holding that it involved distinctions that were rigid, unclear, and difficult to apply. He also rejected the Court of Appeal's hybrid test for the same reasons, and held that the true test is for a causative mistake of sufficient gravity to make it unconscionable to leave the mistake uncorrected. Lord Walker added that this test 'will normally only be

¹⁰ *Pitt* (SC) (n 8) [99] ff.

satisfied when there is a mistake either as to the legal character or nature of a transaction, or as to some matter of fact or law which is basic to the transaction'; and that the question whether it would be unconscionable to leave a mistaken transaction uncorrected cannot be decided 'by an elaborate set of rules' but must be decided by an exercise of judicial discretion following review of all the circumstances 'in the round'.

Applying his test to the facts of *Pitt*, Lord Walker concluded that rescission should be awarded because Mrs Pitt had made a sufficiently grave causative mistake respecting the tax treatment of the settlement to justify the court's intervention, and it did not matter that this had been a mistake as to the 'consequences' rather than the 'effect' of the settlement.

(3) Since 2013

The cases since 2013 have thrown up various issues that will now be discussed.

(a) Causative ignorance

Lord Walker's finding that rescission may be available in cases of 'incorrect conscious belief' and 'incorrect tacit assumption', but not in cases of 'causative ignorance', is problematic for two reasons. The first is definitional: it can often be hard to say whether the facts of a case bring it within the second or the third category. The second is more fundamental, namely that Lord Walker gave no principled justification for awarding a remedy in the first two types of case but not the third. He spoke as though the normative question of when a remedy should be awarded turns on the semantic issue of what the word 'mistake' means. What matters, though, is not whether claimants can sensibly be described as 'mistaken' in everyday speech, but why a remedy should be awarded in some types of case, but not others, where a claimant would not have entered a transaction if he had known information that would have affected his decision-making. There is room for debate about the extent to which claimants should be allowed to reverse such transactions, given that no one's decision-making can be informed by perfect information and everyone must accept some level of risk that their decision-making will be compromised by ignorance. But Lord Walker did not enter into this debate and did not explain his decision to draw the line where he did.

Notwithstanding Lord Walker's findings, the courts have found two (linked) ways to afford 'causatively ignorant' claimants a remedy. The first derives from Lord Walker's own finding in *Pitt* that although rescission is not available in cases of 'causative ignorance', it may be available in cases where the claimant's ignorance of some state of affairs 'leads to an [incorrect conscious] belief or [tacit] assumption which the law will recognise as a mistake'.¹¹ This dictum was followed in *Van der Merwe v Goldman*,¹² where Morgan J held that the claimants' ignorance of a change in the law affecting the tax treatment of their settlement 'led them to a false belief or assumption that the creation of the settlement did not involve a chargeable transfer.' In other words, causative ignorance does not qualify a claimant for relief but it does not disqualify him from obtaining a remedy either, and the facts of a case may support an argument that a 'causatively ignorant' claimant is also a mistaken claimant.

¹¹ *Pitt* (SC) (n 8) [105].

¹² [2016] EWHC 790 (Ch), [2016] 4 WLR 71 [41].

Secondly, the courts have discovered ‘mistakes’ in cases where a settlor has never considered whether particular information might affect his decision-making. This often happens because people often act in reliance on professional advice without understanding it or asking themselves what issues their advisors might have overlooked. *Pitt* itself was like this: Mrs Pitt had had no idea that the settlement might have IHT consequences and had simply followed the advice she was given. These were also the facts of *Freedman v Freedman*.¹³

The claimant’s father in *Freedman* had bought her a house to live in with her son, but she wanted to move and could not find a buyer for the house. Her father therefore lent her the money to buy a second house, on the understanding that this loan would be partly repaid from the sale of the first house when that was achieved. Acting in accordance with her father’s wishes, and on the advice of her father’s solicitor, the claimant executed a settlement of both houses. The point was, first, to shield the properties from her former boyfriend (the father of her child) and any other man with whom she might form a relationship, and, secondly, to ensure that her siblings were treated fairly: the terms of the trust provided that the claimant should have a life tenancy, with a remainder interest to her son, subject to a discretionary power of appointment in favour of the claimant, her son, her siblings and their issue. The claimant’s father died, the first house was sold, and only at this juncture was it realized that the transfer of assets into the trust had produced tax consequences overlooked by the solicitor: the creation of the trust had given rise to an immediate IHT entry charge and ongoing 10-yearly and exit charges. The claimant therefore applied to set the settlement aside on the ground of mistake. Her application was opposed by HMRC, which wished to collect the £156,000 tax liability that had arisen, but Proudman J ordered rescission.

HMRC argued that the claimant had not made a qualifying mistake of the kind described in *Pitt* because she had merely been ignorant of the fact that creating the settlement would produce disadvantageous tax consequences. The claimant replied that she had made a qualifying mistake because she had acted on the basis of an incorrect tacit assumption that her father and the solicitor would not have advised her to enter an arrangement which would trigger a tax liability that would compromise her ability to repay her father’s loan. Proudman J found for the claimant on this issue.

Pitt and *Freedman* both suggest that where a claimant’s professional advisor makes an error of omission, the claimant may obtain a remedy by saying that he made an incorrect tacit assumption that the advisor would consider and advise on all relevant aspects of the relevant transaction, whether or not he was told to do so, and whether or not the claimant was aware that knowledge of some aspect of the transaction would affect his decision whether to enter it. Whether this is too favourable to claimants depends in part on the justificatory reasons for allowing rescission on the ground of mistake, which were not clearly articulated in *Pitt*. However, it does appear to be out of line with the basis on which the rule in *Re Hastings-Bass*¹⁴ was reformulated in the same case.

In *Pitt* Lord Walker affirmed Lloyd’s LJ’s finding that a trustee or other power-holder cannot invoke the rule in *Re Hastings-Bass* to rescind a disposition of trust property if he has acted on advice given by a professional who was

¹³ [2015] EWHC 1457 (Ch), [2015] WTLR 1187.

¹⁴ [1975] Ch 25.

selected with reasonable care, as he would then have discharged his duty to consider all and only relevant matters when deciding whether to exercise the relevant power, and the rule applies only where decisions are made in breach of this duty. The policy reason for this change to the law was that HMRC should not be deprived of tax revenue where the losses caused by mistaken exercises of power by trustees and other power-holders can be recouped from their negligent professional advisers (and their insurers). However, the law governing the rescission of voluntary dispositions for mistake now produces exactly this result, since it enables a trustee or power-holder who disposes of trust property in a way that triggers unforeseen tax liabilities to say that he incorrectly assumed that his lawyer or accountant would have warned him about these. These points appear to have been made by HMRC in *Freedman*, but did not persuade the judge.¹⁵

(b) Sufficiently serious mistake

In the Court of Appeal in *Pitt*, Lloyd LJ laid down a strict test for mistake for the same reason that he reformulated the rule in *Re Hastings-Bass*: to deprive badly advised trustees (and their advisers) of a 'get out of jail free card'. In the Supreme Court Lord Walker agreed that they should not be able to reverse the consequences of their 'tax mistakes' too easily, but his abrogation of the *Gibbon* rule meant that he needed to place some other limit on trustees' ability to claim rescission for mistake. Lord Walker seems to have thought that his 'sufficiently serious mistake' rule could do the job, but the courts have not interpreted this rule in a restrictive way, and Lord Walker himself did not give them a very strong steer in this direction, given that he allowed Mrs Pitt's claim.

The cases since 2013 suggest that it is not hard for claimants to satisfy Lord Walker's test. In *Freedman*, Proudman J held that if the unanticipated consequence of the settlement had only been that IHT was payable, she might have held that the mistake was insufficiently serious. However, the fact that the tax charge made it impossible to repay the loan made a difference, since it meant that 'the settlement was so affected by the tax consequences that its effect was entirely different from that which [the claimant] believed it to be.'¹⁶ In *Wright v National Westminster Bank Plc*,¹⁷ Norris J held that a husband and wife made a sufficiently 'grave' mistake when they transferred property into a discretionary trust in the mistaken belief that the wife could continue to draw income from the trust property during her husband's lifetime. In *Van der Merwe v Goldman* the key factor leading to Morgan J's conclusion that a sufficiently serious mistake had been made was the size of the tax bill resulting from the claimants' arrangements: this amounted to about £450,000.¹⁸ Likewise in *Kennedy v Kennedy*¹⁹ the size of the claimants' tax bill was the clinching factor for Etherton C – in that case, it was around £650,000.

¹⁵ See *Freedman* (n 13) [20]-[21].

¹⁶ *Freedman* (n 13) [41].

¹⁷ [2014] EWHC 3158 (Ch), [2015] WTLR 547.

¹⁸ *Van der Merwe* (n 12) [41].

¹⁹ [2014] EWHC 4129 (Ch), [2015] WTLR 837.

(c) Tax avoidance schemes

In *Pitt*, Lord Walker sought to place a further limit on the availability of rescission in tax mistake cases when he said that in:²⁰

‘some cases of artificial tax avoidance the court might think it right to refuse relief ... on the ground that discretionary relief should be refused on grounds of public policy’.

This dictum does not reflect previous judicial thinking in applications under the Variation of Trusts Act 1958, in which context the courts have frequently ordered variations the sole purpose of which has been to save tax.²¹ It seems, however, that Lord Walker wished to depart from these authorities, having suggested that the time had come to do so in the course of argument to Robert Ham QC, and having received a positive answer to this suggestion from counsel, provided that a line was drawn between cases of tax mitigation and cases of tax avoidance. Ham now regrets having made that concession, as Lord Walker’s new rule was inconsistent with settled authority and should therefore have been introduced by Parliament rather than the court, not least because Parliament had just legislated to introduce a general anti-abuse rule.²²

In *Kennedy*,²³ Etherton C declined to withhold rescission on this ground because the appointment of trust property which the claimants sought to set aside had not amounted to an ‘artificial tax avoidance arrangement’ and had comprised a legitimate attempt to reorganise the trust in a tax efficient manner, in a way that had been expressly contemplated by the Finance Act 2006. In *Van der Merwe*,²⁴ Morgan J went further, and held that it would be inappropriate for him to deny rescission on this ground in light of the Supreme Court’s findings in relation to the *ex turpi causa* principle in *Les Laboratoires Servier v Apotex Inc.*²⁵ He did not elaborate on the reasons for this, but if they turned on the fact that Lord Sumption, speaking for the *Apotex* majority, denied that the courts have a discretion to withhold private law remedies where the claim is tainted by illegality, then they have been overtaken by *Patel v Mirza*,²⁶ where Lord Toulson, speaking for the majority, held that the courts do have such a discretion.

However, Lord Toulson also stipulated in *Patel* that when exercising this discretion the courts should consider the policy of the rule making the relevant transaction illegal, and whether denying a remedy would be disproportionate. In *Pitt*, Lord Walker referred to *WT Ramsay Ltd v IRC*,²⁷ but as Simon Taube QC has written, the *Ramsay* doctrine is ‘not a doctrine that allows the court to refuse equitable relief where it would otherwise be available’: it is merely a rule of statutory construction.²⁸ Where a claimant has entered a botched tax avoidance

²⁰ *Pitt* (SC) (n 8) [135].

²¹ A point made by Steve Evans [2015] Conv 61. See e.g. *Re Sainsbury’s Settlement* [1967] 1 WLR 467; *Re Bernstein* [2008] EWHC 3454 (Ch), [2010] WTLR 559.

²² R Ham QC (2016) 22 T&T 971, 979-981.

²³ *Kennedy* (n 19) [39]. The facts of this case are discussed in the text to n 000.

²⁴ *Van der Merwe* (n 12) [42].

²⁵ [2014] UKSC 55, [2015] AC 430.

²⁶ [2016] UKSC 42, [2016] 3 WLR 399.

²⁷ [1982] AC 300.

²⁸ S Taube QC (2015) 21 T&T 144, 148, citing *Barclays Mercantile Business Finance Limited v Mawson* [2005] 1 AC 684.

scheme, the court would therefore have to look at the Finance Act 2013, Part V, which contains the General Anti-Abuse Rule.

The first question would be whether the relevant arrangements were 'abusive' in the sense used in s 207 of the 2013 Act. If they were not, then refusing to order rescission would clearly go beyond the legislation. But even if they were, the further question would then arise, whether denying rescission would be a disproportionate response. Under s 210, the courts cannot penalise taxpayers for making abusive tax arrangements: they can only make 'just and reasonable' adjustments to counteract the tax advantages procured by the taxpayer's abusive arrangements. However, claimants never seek to rescind arrangements which have produced tax advantages: they only ever seek rescission of arrangements which have gone wrong and produced larger tax liabilities than the claimants would have incurred if they had not done anything at all. Withholding rescission in such cases would effectively penalise claimants, and so it would arguably be disproportionate because it would be inconsistent with Parliament's decision not to penalise entry into abusive arrangements.

(d) Partial rescission

English law does not permit the partial rescission of contracts. If a claimant can set aside a contract, e.g. for misrepresentation or undue influence, then it must be set aside entirely even if the claimant would have agreed to different terms irrespective of the misrepresentation or undue influence.²⁹ It seems, however, that the courts may order partial rescission of voluntary dispositions on the ground of mistake. This follows from Etherton C's decision in *Kennedy v Kennedy*.³⁰

Kennedy created a settlement of property including cash and company shares. The trustees were Kennedy, his wife, and their solicitor. Kennedy had a life interest in possession and there was a power of appointment exercisable in favour of Kennedy, his children and remoter issue. In default of any appointment, the capital was held on trust for the children. The tax treatment of interest in possession trusts was then altered by the Finance Act 2006, but the legislation allowed a transitional period during which trusts could be reorganised to mitigate the effects of this: trustees could create a 'transitional serial interest', which effectively permitted an interest in possession to be terminated in favour of another interest in possession and for that to be a potentially exempt transfer. Kennedy and his wife were advised to take advantage of this opportunity, and to reduce future IHT liability by appointing certain assets to Kennedy and the children. However, the shares had to be kept inside the settlement, as they did not qualify for holdover relief for capital gains tax purposes. The trustees signed a deed of appointment, in which two clauses provided for the appointment of assets to the children, and a third provided that other assets should be appointed irrevocably on trust for Kennedy absolutely. Those assets were listed in a schedule, which included the shares. The effect was to generate a CGT liability of around £650,000. The trustees sought rectification of the clause appointing property to Kennedy by the addition of words to exclude the shares, or alternatively rescission of the clause.

²⁹ *TSB Bank plc v Camfield* [1995] 1 WLR 430; *De Molestina v Ponton* [2002] 1 All ER (Comm) 587.

³⁰ *Kennedy* (n 19).

Etherton C declined to order rectification because although Kennedy and his wife had intended that the clause appointing property to Kennedy should only effect an appointment of cash, the solicitor-trustee had intended that the shares should also be included in the appointment because he mistakenly thought that there were stockpiled losses inside the settlement against which the capital gains could be offset and that Kennedy had intended to use these when making an appointment of the shares to himself. However, the clause could be severed from the rest of the appointment and set aside. Etherton C commenting that:³¹

‘There is authority that there cannot be partial rescission of a contract; it must be set aside as a whole and not only as to part ... That limitation makes sense in a contractual context and as preventing the court in effect imposing a different contract to the one the parties actually made. I see no reason, however, why that limitation should apply to a self-contained and severable part of a non-contractual voluntary transaction.’

(e) Proprietary relief

It is often said that the intervention of third party rights constitutes a bar to rescission in equity. However, the courts have generally managed to protect third party purchasers from a defendant without barring rescission, e.g. by letting them keep the relevant asset but making the defendant hand over the proceeds of sale or exchange products.³² This type of order is possible because the courts have held that equitable rescission of a contract under which legal title to property was transferred to a defendant leads to the retrospective imposition of a trust on the property, so that the claimant can trace into substitute assets held by the defendant and assert an equitable proprietary claim to those instead.³³ It seems that similar rules apply where voluntary transactions are rescinded for mistake, following *Bainbridge v Bainbridge*.³⁴

The claimants were a father and son, who farmed in partnership. They were concerned about possible claims against their land from other children of the father on his death, and a possible claim from the son’s wife on divorce. The claimants said (though the solicitors denied it) that they were advised by their solicitors to transfer several pieces of land into a discretionary trust and were incorrectly advised that this would not trigger a charge to CGT. Two pieces of land were later sold by the trustees, and the sale proceeds were used to buy new land. It was then discovered that the transfer of the land into the trust had triggered CGT liabilities in excess of £200,000. The claimants applied to have the trust set aside. However, they accepted that the purchasers of the trust land had been in good faith and did not seek an order impugning the sales. Instead they sought an order that legal title to the new land should be transferred to them.

³¹ *Kennedy* (n 19) [46].

³² e.g. *Fox v Mackreth* (1788) 2 Bro CC 44; *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392, 434. Discussion in D O’Sullivan, S Elliott and R Zakrzewski, *The Law of Rescission* (2nd edn, 2014) paras 20.23 ff.

³³ e.g. *Banque Belge pour l’Etranger v Hambrouck* [1921] 1 KB 321 at 332; *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 387-390; *Twinsectra Ltd v Yardley* [1999] Lloyd’s Rep Bank 438 at [99]; *Shalson v Russo* [2003] EWHC 1637 (Ch), [2005] Ch 281 at [120]-[127]; *Papamichael v National Westminster Bank plc (No 2)* [2003] EWHC 164 (Comm), [2003] 1 Lloyd’s Rep 341.

³⁴ [2016] EWHC 898 (Ch), [2016] WTLR 943.

Master Matthews granted the order sought. He accepted that an important bar to rescission is that third parties must not be deprived of rights which they have acquired in good faith. However, he said:³⁵

‘that is a bar to rescission resulting in the rights *now belonging to the third parties* being restored to the claimant. It is not a bar on other rights being so restored, if that is possible.’

The claimants were entitled to the new land by analogy with Rimer J’s findings in *Shalson v Russo*, that:³⁶

‘upon rescission of a contract for fraudulent misrepresentation, the beneficial title which passed to the representor under the contract reverts in the representee. The representee then enjoys a sufficient proprietary title to enable him to trace, follow and recover what, by virtue of such reversioning, can be regarded as having always been in equity his own property.’

The present case concerned unilateral mistake, but:³⁷

‘[the] consequence of the rescission is the same whether it takes place because of fraudulent (or negligent) misrepresentation, or because of causative and basic unilateral mistake.’

(f) Bilateral transactions

Lord Walker’s comments in *Pitt* only concerned the equitable jurisdiction to rescind voluntary dispositions for mistake, and they do not apply to dispositions made under pension schemes and other contractual arrangements. Such cases are covered by the rule that a bilateral transaction can only be set aside for mistake if the error makes the thing transacted for essentially different from the thing that it was believed to be.³⁸ So held Park J in *Smithson v Hamilton*.³⁹ This suggests that on suitable facts, HMRC and other parties wishing to oppose rescission might get some mileage out of arguing that the case concerns a transaction entered pursuant to a contractual obligation. In the absence of facts supporting the existence of a contract, however, this argument will not succeed.

This is demonstrated by *Van der Merwe v Goldman*.⁴⁰ A husband and wife were the joint freehold owners of a house which they occupied as their family home. On 24 March 2006 they executed a transfer of the title to the house to the husband alone, for no stated consideration. On 27 March the husband transferred title to himself and his wife as the trustees of a settlement for the benefit of the husband, the wife, their children and remoter issue. The purpose of these

³⁵ *Bainbridge* (n 34) [20] (his emphasis).

³⁶ [2003] EWHC 1637 (Ch), [2005] Ch 281 [122].

³⁷ *Bainbridge* (n 34) [30].

³⁸ *Great Peace Shipping Ltd v Tsavlis Salvage (International) Ltd* [2002] EWCA Civ 1407, [2003] QB 679.

³⁹ [2007] EWHC 2900 (Ch), [2008] 1 WLR 1453 [123], declining to follow dicta to the contrary in *AMP (UK) plc v Barker* [2001] Pen LR 77 [80]-[82] (Lawrence Collins J) and *Gallaher Ltd v Gallaher Pensions Ltd* [2005] EWHC 42 (Ch), [2005] Pen LR 103 [150] (Etherton J).

⁴⁰ *Van der Merwe* (n 12).

arrangements were to obtain certain tax advantages: they calculated that no IHT would be payable and, because the settlor would not become domiciled in the UK until 6 April, money could be borrowed against the security of the house, to be invested outside the UK as excluded property falling outside the IHT net. These plans went awry owing to changes to the tax treatment of interest in possession settlements announced in the 2006 Budget as taking effect from 23 March 2006. In 2012, the parties discovered that as a result of these changes, they had become liable to pay substantial IHT charges. They applied for an order that the transfer of legal title and settlement should be set aside on the ground of mistake, and Morgan J made the order sought.

HMRC argued that the husband and wife had made a contract under which the wife agreed to transfer her half share in the house to her husband in exchange for him executing the settlement under which she was a beneficiary. They replied that the transfer of legal title was an outright gift leaving the husband free to deal with the house as he pleased, there being no intention to create legal contractual relations. Morgan J found for the husband and wife on this issue. The wife had transferred legal title to the house as part of a single arrangement, the point of which was for the parties to settle the house on trust for themselves and their issue. It followed that the case was governed by the rules governing rescission of voluntary settlements laid down in *Pitt* rather than the stricter rules governing the rescission of contractual arrangements laid down in *Great Peace Shipping*.

(4) Conclusion

Although the rule in *Re Hastings-Bass* was significantly cut down by the Supreme Court in *Pitt*, and although that change in the law was motivated by considerations which one might have thought would also affect the rescission of voluntary dispositions for mistake, it is now comparatively easy for trustees and power-holders to invoke mistake as a means of escaping from the unintended tax consequences of their decisions to dispose of trust property; settlors can easily rescind their settlements on the same ground. HMRC do not view these developments with equanimity, and have argued against rescission in several of the foregoing cases, but so far their arguments have fallen on deaf ears.

C. JERSEY LAW

(1) Prior to 2013

The Jersey legislature and courts have been similarly (if not more) generous to settlors and trustees, and they have been forthright in stating why. In *Re R*, Commissioner Bailhache declined to adopt the hybrid test laid down for English law by the Court of Appeal in *Pitt*, and explained:⁴¹

[We are troubled by the weight given by this test] to the interests of the tax authority. We entirely accept that it is open to the courts of any country to lay down their own judicial policy in relation to the exercise of an equitable jurisdiction. The preference accorded to the interests of the tax authority in the UK is not one, however, with which we are sympathetic. In our view, Leviathan can look after itself. ... [In] Jersey it is still open to

⁴¹ [2011] JRC 117 [39].

citizens so to arrange their affairs, so long as the arrangement is transparent and within the law, as to involve the lowest possible payment to the tax authority. ... We accordingly see no reason for adopting a judicial policy in this country which favours the position of the tax authority to the prejudice of the individual citizen, and excludes from the ambit of discretionary equitable relief mistakes giving rise to unforeseen fiscal liabilities.'

In *Re R* the court therefore reaffirmed the finding by Commissioner Clyde-Smith in *Re the A Trust*⁴² that the effects / consequences distinction forms no part of Jersey law, and that under Jersey law voluntary dispositions can be set aside in cases of serious causative mistake, i.e. where they would not have been entered but for a mistake that was of 'so serious a character as to render it unjust on the part of the donee to retain the property.'⁴³ As previously discussed, the Supreme Court rejected the hybrid test espoused by the Court of Appeal in *Pitt* and affirmed the *Ogilvie* test; and as subsequently noted in *Re the Strathmullen Trust*, the effect of this decision was 'broadly to align' English and Jersey law.⁴⁴

(2) The Trusts (Amendment No 6) (Jersey) Law 2013

In the same year, the Trusts (Amendment No 6) (Jersey) Law 2013 was passed. This preserved the rule in *Re Hastings-Bass* in the form which it had taken in English law prior to its curtailment in *Pitt*. More pertinently for present purposes, it also gave statutory force to the principles laid down in the Jersey cases on the rescission of voluntary dispositions for mistake. These principles can now be found in the amended version of the Trusts (Jersey) Law 1984, as follows.

Article 47E provides that the court may set aside a transfer of property into a trust where the settlor made a causative mistake 'of so serious a character as to render it just for the court to make a declaration'. Article 47G provides that the court may set aside an exercise of power in relation to a trust or trust property where the trustee or other power-holder made a mistake of the same character. Article 47B defines 'mistake' to include mistakes as to the effects, consequences, and advantages of a transfer, mistakes of past and present fact, and mistakes of law (including the law of a foreign jurisdiction). Article 47C provides that the Jersey customary law doctrine of *erreur* does not apply in this context, resolving a question previously raised in *Re the B Life Interest Settlement*,⁴⁵ where it was suggested that because a gift can form a contract under Jersey customary law, the contractual rules of *erreur* might govern the rescission of gifts into a settlement.

⁴² [2009] JRC 447, [2009] JLR 447.

⁴³ Further decisions to this effect included *Re the Lochmore Trust* [2010] JRC 068; *Re S Trust* [2011] JRC 117, [2011] JLR 275; and *Seggins v Apex Trust Co Ltd* [2013] JRC 077.

⁴⁴ [2014] JRC 056 [20]. See also *Re the Great Escape Trust and the Wentworth Trust* [2015] JRC 259 [28].

⁴⁵ [2012] JRC 229, [2013] JLR 1.

(3) Since 2013

The cases since 2013 have thrown up various issues that will now be discussed.

(a) Scheme of the Trusts (Jersey) Law 1984

The 2013 amending law left it unclear how the new Articles related to the existing provision in Article 11(2)(b)(i), that a trust shall be invalid to the extent that the court declares that the trust was established by mistake. In *Re the Strathmullen Trust*,⁴⁶ the court held that the new Articles are intended to be additional provisions to those in Article 11 and are not intended merely to be aids to construction of the Article 11 provisions. This is so despite the fact that:

‘if all transfers of property into a trust are set aside under Article 47E as a result of a relevant mistake made, there may as a consequence be no property in the trust at all [with the] result ... that while there once was apparently a trust with property in it, there is no longer trust property, and pursuant to Article 2, the trust itself ceases to exist.’

The same point was made, but the same conclusion drawn, in *Re the Robinson Annuity Investment Trust*,⁴⁷ and revisiting this issue in *Re the Great Escape Trust and the Wentworth Trust*,⁴⁸ the court held that where it is sought to rescind transfers which immediately constituted a trust, Article 11 applies, but that Article 47E applies where transfers are made into an existing trust.

(b) Sufficiently serious mistake

Like the English courts, the Jersey courts are quick to find that a sufficiently serious mistake has been made to justify rescission in cases where unanticipated tax liabilities of any magnitude have arisen.⁴⁹ Unlike the English courts, the Jersey courts have also said that it would be positively undesirable to require settlors and trustees to sue their professional advisers for negligence as an alternative to setting their dispositions aside.

For example, in *Re the Strathmullen Trust* the court thought that it would be ‘seriously unjust’ to require the settlor to do this when the outcome of any litigation against his advisers was uncertain.⁵⁰ Still more strikingly, in *Re the Great Escape Trust*, the court rescinded a settlement even though no adverse financial consequences would have ensued for the settlors if rescission had not been granted, as they had already sued the promoters of the botched tax avoidance scheme they had sought to implement and as part of a settlement agreement with them had won an indemnity against any tax liability which they might be found to owe if the trust were not rescinded. Nevertheless the court held that their mistake was sufficiently serious to justify the court’s intervention. There was:⁵¹

‘something unattractive about the proposition that the Court should come to the rescue of foreign tax payers who, anxious to avoid paying the

⁴⁶ [2014] JRC 056 [12]-[18].

⁴⁷ [2014] JRC 133 [26]-[31].

⁴⁸ [2015] JRC 259 [21]-[22].

⁴⁹ e.g. *Re Z Trust Ltd* [2016] JRC 048 [35].

⁵⁰ *Strathmullen* (n 46) [27].

⁵¹ *Great Escape* (n 48) [36].

contribution towards the outgoings of their own jurisdiction's government, and thus meet their own obligations as citizens of that jurisdiction, make schemes of this nature.'

Nevertheless, relief should be granted because the settlors had already suffered the stress of risky litigation against their professional advisors for 4 years, and it was probable that denial of relief would lead to more stressful litigation on appeal.

(c) Tax avoidance schemes

The latter case brings to mind Lord Walker's dictum in *Pitt* that the courts might choose not to exercise their equitable discretion to set dispositions aside where these have been made as part of a botched tax avoidance scheme – although as previously discussed, it is doubtful whether it would be appropriate for the courts to withhold relief on this ground. It is telling that this idea played no part in the court's thinking in *Re the Great Escape Trust*. Nor was the court willing to entertain such a principle in *Re the Strathmullen Trust*.

The settlor in the latter case sold his shares in the family business for £2.1 million and moved to the Isle of Man where he established a settlement governed by Jersey law. The trust property consisted of shares in a Jersey-registered company to which the money was paid; the beneficiaries were the settlor and his wife, with long stop trusts for charitable purposes. The purpose of this arrangement was to avoid IHT. However, the settlor's advisors overlooked deemed domicile provisions in the UK tax legislation which meant that in spite of his move to the Isle of Man, he continued to be treated as domiciled in the UK for IHT purposes for 3 years after his move. As a result significant charges to IHT arose in relation to the transfers into trust. The settlor applied to have the settlement set aside on the ground of mistake and the Royal Court of Jersey granted this application.

The court noted Lord Walker's dictum, but brushed it aside:⁵²

'There is clearly more than one approach that one could take to what Lord Walker describes as an issue of some importance in the United Kingdom, and the arguments would be further complicated in this jurisdiction by a recognition that the social evil of artificial tax avoidance which puts an unnecessary burden on the shoulders of those who do not adopt such measures might receive a different emphasis where it is not our domestic taxation system which is being avoided. The complexity of such arguments, including the difficulties in establishing what amounts to a social evil where the relevant jurisdiction's legislature can be assumed to have taxed everything that it intended to tax (which makes avoidance, on one analysis, entirely legitimate) emphasises that in the absence of any contentions to the contrary, it is unnecessary to consider such an issue further in this case.'

⁵² *Strathmullen* (n 46) [25].

Perhaps unsurprisingly, similar comments have also been made elsewhere in the offshore trust world. In *Nourse v Heritage Corporate Trustees Ltd* Deputy Bailiff MacMahon said that where a transaction:⁵³

‘did not avoid payment of any tax due to the States of Guernsey ... the Jurats might feel that the underlying purpose of the transaction did not itself add anything either way as to whether it would be unconscionable, or unjust, to leave any mistake they might find uncorrected.’

Similarly, Smellie CJ has said extra-judicially that:⁵⁴

‘In the socio-political context of the Cayman Islands, there can be no presumption that an arrangement, which is otherwise within the law not only of the Cayman Islands, but also of the relevant domiciliary jurisdiction, is to be deemed “artificial” simply because its primary aim is to mitigate the incidences of tax.’

(4) Conclusion

The Jersey legislature and courts lean more overtly than the English courts towards favouring the interests of settlors, trustees and their professional advisors over the interests of tax authorities, particularly foreign tax authorities. But the generosity of the English courts towards the former group means that the disparity between the approaches taken by the two systems towards rescission for mistake is now less pronounced than it was before.

⁵³ Unreported, Royal Court of Guernsey, 1 January 2015, [16]. See too the Jurats’ statement at [71] that they did ‘not regard the fact that the Applicant was participating in a scheme to avoid payment of taxes in the United Kingdom as any reason to refuse to grant the relief if it would otherwise be given.’

⁵⁴ ‘Chief Justice Smellie, ‘Dealing with Mistakes of Trustees or Settlers: The Outlook from the Offshore Bench’ (2014) 20 T&T 1101, 1109. On the same general theme, see also Deemster Doyle’s remarks in *AB v CD*, unreported, Isle of Man Ch D, 30 June 2016.