Escaping from mistakes as to tax consequences in Guernsey – Gresh v RBC Trust Company revisited

Insights - 20/03/2017

In a recent decision the Royal Court has considered whether to set aside a distribution on the grounds of equitable mistake in circumstances where that mistake led to adverse UK tax consequences.

This is the first time that the Guernsey law principles of equitable mistake have been considered in Guernsey since the seminal decision of the UK Supreme Court in Pitt v Holt[1] in 2013. It should also be noted that Jersey introduced a statutory basis for mistake in 2013, whereas Guernsey has not made any similar enactments.

The Facts

The facts can be summarised as follows:

- Mr Gresh was a member of a pension plan administered by a Guernsey trustee;
- Mr Gresh had been advised by independent tax advisers that any lump sum distribution made to him would be tax-free provided that the distribution was not remitted to him in the UK. When he turned 50, Mr Gresh requested a lump sum distribution from the trustee of his pension fund;
- The trustee believed the advice to be accurate and gave instructions for the requested transfers to be made;
- The advice was wrong in that only periodic payments would be tax-free even if any capital sum was retained outside the UK. The distribution made to Mr Gresh has been assessed in the UK to a tax liability of 40%, leaving Mr Gresh facing a very significant tax bill.

Mr Gresh's application, originally before the court in 2010, requested the setting aside of the distribution on Hastings-Bass principles, but following the Supreme Court decision in Pitt the application was amended and proceeded upon the grounds of equitable mistake. Whilst HMRC was not initially a party to the application, it was joined as a result of a decision of the Guernsey Court of Appeal in 2010[2] (read our previous briefing here). HMRC opposed the application whilst the trustee remained neutral.

Issues and Decision

The application was heard by the Bailiff who considered that Pitt was highly persuasive in Guernsey and that he knew of no reason why under Guernsey law the principles set out by Lord Walker in Pitt should not be applied in Guernsey. The main issues for the Royal Court to consider were:

1. What was the legal test set out by the Supreme Court in 2013? Was it simply that the mistake be of sufficient gravity to justify it being set aside on the ground that it would be unconscionable or unjust to leave the mistake uncorrected? Or alternatively was the test that the mistake was sufficiently serious for it to be unconscionable for the donee to retain the property given to him?

2. What is the meaning of 'unconscionability' (or unjust or unfair) in these circumstances?

The Bailiff ruled that the Supreme Court decision in Pitt had not altered the test for equitable mistake. What is required is to look at all the relevant circumstances of the mistake and the consequences for the person who made the transfer in question in order to evaluate objectively the injustice or leaving the disposition uncorrected.

Applying these principles, the Bailiff found that it would not be an appropriate exercise of the Court's jurisdiction to set aside the disposition. Whilst it was clear that Mr Gresh (and the trustee) had believed and relied upon advice which turned out to be incorrect and nor was he seeking to pursue an aggressive tax avoidance scheme (which the court would not want to support for reasons of public policy), in his judgment it was not unconscionable for Mr Gresh to retain the proceeds of the distribution made to him by the trustee for the following reasons:

- In Pitt, a significant element in the Supreme Court's analysis was that if the mistake had not been corrected, there would have been insufficient funds in the settlement available to provide for Mr Pitt in circumstances where the settlement had only been created in order to provide for his care following serious injuries suffered in an accident.

- The only person affected in this case was Mr Gresh himself who would have a large tax liability if the mistake was not corrected. The Bailiff noted that in other cases where courts in Jersey and the UK had been persuaded to set aside dispositions made due to errors as to tax consequences there had been other parties whose interests were affected, such as spouses, children, and other people for whom the settlements were founded to protect.

- Another factor was that Mr Gresh had a contractual relationship with the tax advisers who had provided the incorrect advice and therefore it could be distinguished from cases where it has been found unjust to require settlor/beneficiaries to bring litigation against former professional advisers.

Comment

The clear guidance from the Royal Court that not every mistake as to tax consequences based on incorrect or negligent professional advice will be corrected by the courts is noteworthy. Whilst the Court was not in a position to form a view as to whether Mr Gresh may have an action against his tax advisers, this was a reminder that there are occasions when it is more appropriate for professional indemnity insurers to pick up the pieces rather than the courts. In some circumstances such actions may now be the more attractive option since the previous decision of the Royal Court in this matter indicated that a foreign revenue authority may be able to intervene in the trust proceedings.

The Royal Court also demonstrated that in considering the requirement that it would be unjust or unconscionable to leave the mistake uncorrected, it is not concerned with whether the donor was engaged in tax avoidance. The Royal Court has previously set aside transactions where the parties were found to be engaged in tax avoidance, whereas it was clear Mr Gresh was not involved in such activity. In fact the crucial element was that, whereas most cases involve setting aside transfers from donors to trustees, here the transfer was in the opposite direction and it was Mr Gresh himself and no-one else who retained the benefit of the distribution.

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[1] [2013] UKSC 26

[2] 2009-10 GLR 239

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