Setting aside subsequent transfers to trusts - Jersey's statutory law of mistake in operation.

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The enactment of the Trust (Amendment No 6) (Jersey) Law 2013 (Amendment 6), saw Jersey introduce a statutory basis for relief to be granted for mistake in the form of Article 47E of the Trusts (Jersey) Law 1984 (the Law). There have been a number of decisions of the Royal Court in this area since then, although until the decision in *In the Matter of the D, E and F Trusts* those cases were decided on the basis of the pre-existing law. Whilst the Court (for example in *In the Matter of the Strathmullen Trust* and *The Representation of the Robinson Annuity Investment Trust*) had previously considered the potential application of Article 47E, and the interplay between the pre-existing law (particularly Article 11 of the Law) largely concluding on facts of earlier cases that the pre-existing provisions of the Law applied, the decision in *In the Matter of the D, E and F Trusts* represents the first time that the Court has granted relief for mistake squarely within Article 47E.

Statutory provisions for mistake in Jersey

The statutory framework for mistake in the Law following the enactment of the Amendment Law is contained in Articles 47B to J. Article 47E provides (in relevant part) as follows:

> *(1) ...*
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> *(2) The Court may on the application of any person specified in Article 47I(1), and in the circumstances set out in paragraph (3), declare that a transfer or other disposition of property to a trust -*
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> a. *By a settlor acting in person (whether along or with any other settlor); or*
>
> *b. Through a person exercising a power,*
>
> *Is voidable and -*
>
> *i. has such effect as the court may determine, or*

ii. Is of no effect from the time of its exercise.

(3) The circumstances are where the settlor or person exercising a power –

a. Made a mistake in relation to the transfer or other disposition of property to a trust; and

b. Would not have made that transfer or other disposition but for that mistake, and

The mistake is of so serious a character as to render it just for the court to make a declaration under this Article.

The meaning of a mistake for the purposes of Article 47E is set out in Article 47B(2) of the Law which provides as follows:

(2) In Articles 47E ….., "mistake" includes (but is not limited to) –

(a) a mistake as to –

(i) the effect of,

(ii) any consequences of, or

(iii) any of the advantages to be gained by,

a transfer or other disposition of property to a trust, or the exercise of a power over or in relation to a trust or trust property;

(b) a mistake as to a fact existing either before or at the time of, a transfer or other disposition of property to a trust, or the exercise of a power over or in relation to a trust or trust property; or

(c) a mistake of law including a law of a foreign jurisdiction.

Article 11 of the Law provides in more simple terms (as relevant for current purposes) at sub-paragraph (2) that: *"…. a trust shall be invalid – (b) to the extent that the court declares that – (i) the trust was established by …. mistake…*".

Principles established in cases since the enactment of Article 47E

The Royal Court has considered the legal basis for an order seeking a transfer of property on to a trust to be set aside on grounds of mistake and declared void on a number of occasions since the enactment of Amendment 6.

The first in time was the decision in *In the matter of Strathmullan Trust* in which the then Deputy Bailiff considered the interplay between Articles 11 and 47E. He noted that relief under Articles 47B to 47H of the Amendment required the pre-existence of a trust in order for the Court's discretion to declare a transaction voidable to be successfully invoked, whereas relief under Article 11 could be applied for where the creation, validity and duration of a trust was at stake. On that basis he concluded that the provisions were distinct from one another, that Article 11 still stood and was not now subsumed within Article 47E and that he would approach the application before the Court under Article 11 of the Law.

The following year, *In the Matter of the S Trust and In the Matter T Trust* the Court outlined the following points of broad application building on the analysis in *Strathmullen*:

a. Article 11 of the Law relates to the invalidity of a trust as a whole;

b. In so far as transfers included the transfer which immediately constituted the trust, Article 11 would apply;

c. In so far as a transfer is made to an existing trust, Article 47E would apply; and

d. For the purposes of Article 11 or 47E it does not matter whether the asserted mistake was of fact, law, as to the effect or as to consequences and as such a mistake as to the tax consequences of a trust or a transfer to a trust is a mistake for these purposes.

In the Matter of the S Trust and In the Matter of the T Trust, the Court noted the difference between the language of the third limb of the three stage common law test summarised in *Re Lochmore Trust* and the language used in the third limb of the statutory test set out in Article 47E(3) of the Law. Under the test summarised in *Re Lochmore Trust* and settled in *Re S Settlement* and which is applicable to applications brought under Article 11 of the Law, the Court must ask itself the following questions:

a. Was there a mistake on the part of the settlor?

b. Would the settlor not have entered into the transaction "but for" the mistake?

c. Was the mistake of so serious a character to render it unjust on the part of the donee to retain the property?

In the Matter of the Robinson Annuity Investment Trust having considered the language in the statutory test and the judicial test the Court concluded:

> *"...What is clear, however is that the test to be applied by the Court is identical whether the matter is considered under Article 11 or Article 47E. Thus the statutory test enunciated in Article 47E(3) is for all practical purposes identical to the test established by the Court prior to the Amending Law and encapsulated in a number of cases which were summarised in Re Lochmore..."*

In *In the Matter of the S Trust and In the Matter of the T Trust* the Court held that:

> *"…the judicial test, in requiring the court to consider whether it is unjust on the part of the donee to retain the property, seems…to contemplate that the Court is measuring justice by reference to the position of the donee….the focus of the statutory test, by contrast, is whether it is just for the court to make a declaration that a disposition of property to a trust is voidable….because of a mistake made by the donor."* It clarified that there might be a factual circumstance where the distinction is relevant but that *…."in most cases the result of the statutory and judicial tests will be the same"*

The Court went on when considering the third element of the test to identify factors that could militate against the granting of an order to set aside a transfer on the grounds of mistake. In essence, these are factors which point to a lack of any financial consequences adverse to the beneficiaries.

Further analysis of Article 47E

In *In the matter of the S Trust and the T Trust* the respective settlors of the trusts had settled the trusts on the basis of advice from an English financial advisor with a principal aim of avoiding UK inheritance tax in respect of English properties. The scheme as recommended to the settlors involved funds being borrowed to repay existing mortgages on the English properties and the balance invested into gilts and other assets to be held in the Jersey trusts. The lending was secured on the English property and also by way of guarantees from the trustees, and was repayable only upon the settlors' death. In fact, rather than avoiding inheritance tax, the scheme lead to significant inheritance tax charges including an immediate 20% charge, rendering the property subject to 10 yearly charges and potentially leaving the settlors with a deemed entitlement to the trust assets so as to bring those assets within their estates on death.

In terms of principles emerging from the Court's judgment, it was confirmed that the first two limbs of the test for mistake are the same whether under the pre-existing law or Article 47E. However, the third limb of the test for mistake as provided in Article 47E is inverted, in as much as the case law test incorporates the question whether it is unjust on the part of the donee (the trustee recipient) to retain the settled property, whereas under the statute the test is whether it is just for the Court to make a declaration (ie to set aside the disposition into trust). The Court considered the margins of this difference to be *very fine* but noted that, depending upon the facts of each case, the distinction could be relevant.

Further the Court noted in relation to the question of there being a period of time between the settlement of the Trusts and the disposition of the assets into the Trusts, that it will typically adopt what it described as a "realistic" approach. This means that, when considering applications to set aside a trust on the basis of a mistake (most likely under Article 11 of the Law) the Court will treat the establishment of a trust and the separate disposition of assets onto the trust in the round.

However, where there is a more significant distance between the two transfers, the provisions of Article 47E will be relevant.

Relief under Article 47E - In *The Matter of the D, E and F Trusts*

The Royal Court's decision in *In the Matter of the D, E and F Trusts* was handed down in September 2016. In granting relief under Article 47E the Court set aside transfers of shares into three Jersey trusts a number of years after the trusts were established and in circumstances where the mistake in question gave rise to a contingent, rather than a crystallised tax liability. The Court also clarified that notwithstanding foreign law governed the transfers of the shares to the trusts, Jersey's firewall provisions required the question of the validity of those transfers to be determined under Jersey law.

The application by the Settlor concerned the transfer of shares by him in Luxembourg companies (which in turn held substantial shareholdings in a public company) by a Settlor in 2011 to be held on three Jersey law trusts: the D Trust, E Trust and F Trust (together the Trusts) (the Transfers). The Trusts had originally been established in 2009 with the settlement of a nominal cash sum, but were amended in 2011. The Trusts were settled to benefit the Settlor during his lifetime and his family thereafter, but also to achieve certain US tax objectives, the most relevant being to ensure that any distributions to the Settlor's two sons were not subject to US tax and to ensure that no part of the assets held by the Trusts would be subject to US estate tax upon the death of the Settlor (who was Swiss resident) or either of his sons (who were both US resident).

The amendments to the Trusts in 2011 were effected to mitigate against a potential change in Swiss estate tax law, the effect of which would have been to expose the Settlor's assets (including the valuable shareholdings subsequently transferred to the Trusts) to a substantial Swiss estate tax charge. On making the amendments, however, it was also important for the Trusts to continue to achieve the original US tax objectives. The provisions of US and Swiss law required different principal features for the Trusts, although none of which were mutually exclusive - the Settlor obtained advice on the proposed amendments in order to adopt changes that would address the competing risks of US tax liability and the potential Swiss tax liability.

The amended Trusts were stated to comprise completed gifts to the Settlor's sons and, in the event of their death prior to the expiry of the Trusts, to their children and his grandchildren. Each Trust had three Trustees (respectively called the family, administrative and independent trustee, the latter of which held dispositive powers). The Settlor's sons were the family trustee of the D Trust and the F Trust respectively, and together the family trustees of the E Trust. The sons were also protectors.

The amendments to the Trusts introduced an unintended provision that gave rise to a potentially significant US tax liability, by granting to each of the sons in their respective capacities as protectors of the Trusts, the power to remove the independent trustee and appoint as independent trustee, himself or a person related or subordinate to him. The power as drafted, (which had been

addressed in an early draft by the US lawyers but was not identified in the final draft which had changed) amounted for the purposes of US tax law to a 'general power of appointment' over the Trust assets in favour of the sons. As a consequence, if the sons were to die prior to the expiration of the Trusts, the value of the respective Trust assets would be deemed to fall within their estates for US estate tax purposes and could attract US estate tax at a rate of up to 40%.

Ultimately the applicable Swiss tax law was not changed and therefore the Swiss tax risk fell away. However it was only some years later that the Settlor's advisors identified the risk of the US estate tax charge by reference to the power of appointment. There were no means under the Trusts instruments that could be adopted in an effective way for US tax purposes to remedy the issue. Therefore the Settlor applied to have the Transfers set aside and declared void on the grounds of mistake pursuant to Article 47E with the effect that the shares would be declared to have been held at all times on bare trust by the trustees for the Settlor.

The Court noted that where an application based on mistake does not seek to set aside the trust but, rather, seeks to set aside only the disposition of assets on to the trust, and particularly if such transfers took place some time after the establishment of the trust, the application can squarely be brought under Article 47E of the Law. Accordingly, recognising that previous decided applications since the Amendment sought the setting aside of the trust or the original transfer of assets at or very shortly after the establishment of the trust, the Court accepted that this was not an application that could properly be brought under Article 11.

The Court applied the three questions reflected in the 2013 amendments to the Law, namely: was there a mistake on the part of the Settlor? Would the Settlor not have made the Transfers but for the mistake? Was the mistake of so serious a character as to render it just for the Court to make a declaration?

The Court had no hesitation answering the first two questions affirmatively (based upon the error in the drafting of the Trusts instruments at the time of the amendment, noting the US tax advice subsequently received, and upon accepting the Settlor's affidavit evidence that he would not have made the Transfers had he known of the tax implications). The third question was a more difficult one. Whilst mistake applications have typically been brought in respect of mistakes which have given rise to an existing tax liability, in this case, the tax liability was entirely contingent upon either of the Settlor's sons dying prior to the expiry of the Trusts (in 2041). The Royal Court concluded that such a contingent risk could be a consequence which renders the mistake so serious that it is just that the transfers be set aside. Its reasoning included the following:

- Notwithstanding its contingent nature, the magnitude of the potential liability weighed heavily in favour of granting the relief. In particular the tax liability may have led to the Settlor's sons' respective families having to divest themselves of the shares (the original company having been created by the Settlor's father)
- It was the Settlor's clear intention that his assets go to the beneficiaries of the Trusts and none

of the beneficiaries would be likely to suffer if the Transfers were set aside

- The Settlor was not a US tax payer, the trusts were not artificial schemes but merely intended to achieve tax efficient estate planning which gained for the Settlor no interim advantage

Conflicts of law and Article 47E applications

The Royal Court also considered in its decision the potential conflicts of law issues that arose in circumstances where the agreements effecting the Transfers were governed by Swiss law save to the extent that Luxembourg law was compulsory or mandatory. Clearly with many Jersey law trusts being used for a variety of purposes and aims involving parties and assets located in multiple jurisdictions, applications pursuant to the mistake doctrine in Jersey will throw up the potential for conflict between the law governing the asset or the transaction pursuant to which the disposition was effected (with shares in a foreign company being a prime example), and Jersey trust law.

The question posed by the Court was whether the question of the validity of the Transfers should therefore be determined pursuant to Swiss or Luxembourg law. The application was premised on the argument that the firewall provisions of Article 9 of the Law required the application of Jersey law to the question of the validity of the Transfers. Article 9 provides as follows:

> *(1) Subject to paragraph (3), any question concerning –*
>
> *(a) …;*
>
> *(b) the validity or effect of any transfer or other disposition of property to a trust;*
>
> *…*
>
> *shall be determined in accordance with the law of Jersey and no rule of foreign law shall affect such question."*

The Court noted that Article 9(2) of the Law expressly requires that any determination of the validity or effect of any transfer or other disposition of property to a Jersey trust is to be determined without consideration of whether or not the foreign law prohibits or does not recognise the concept of a trust. The Court questioned the potential impact of Article 9(2A) which provides that Article 9 (1) not, in determining the capacity of a corporation, affect the recognition of the law of its place of incorporation, nor does it affect the recognition of the law of any other jurisdiction prescribing the formalities for the disposition of property.

The Court considered previous decisions in which the issue of whether the proper law of the transaction subject to the application was English law and concluded that whilst Article 9(2A) demonstrated that the legislature was not seeking in Article 9 to validate using Jersey law what would otherwise be invalid transactions under their applicable law, the effect of setting aside

those transactions as a disposition onto trust as matter of Jersey law would be to vary the trusts upon which the assets were held by the Jersey trustee.

The Court accordingly agreed with the arguments advanced on behalf of the Settlor in that regard to the effect that the consequence of any order that the Transfers were invalid under Jersey law would merely result in the trustee, as transferee, holding the asset upon a different trust - namely as bare trustee for the transferor. In any event, before the Court was expert evidence of Luxembourg law to the effect that a Jersey court order setting aside the Transfers could be used as a basis under Luxembourg law to rectify the share registers of the Luxembourg companies.

Conclusion

It has taken 3 years since the enactment of the Amendment for a case to be determined solely on the basis of Article 47E. It is apparent that, not unsurprisingly given that the drafting of the applicable test was based essentially on the existing common law test, the approach the Court takes when considering such applications is materially identical to that followed under the pre-existing law. However, the Court in decisions preceding *In the Matter of the D, E and F Trusts* had identified the nuanced difference in the third limb of the test and it remains to be seen whether that will ultimately be demonstrated to be decisive in any future cases on their facts. The willingness of the Court to take account of contingent prejudice (in this case potential estate tax liabilities on the settlor's children's estates that could have run into in excess of USD100m) demonstrates that the jurisdiction remains one where the Court will consider the overall justice of the circumstances it is presented with when it has first determined that a mistake has been made and but for that mistake the transfer would not have been made. However, the counter to that is that the Royal Court in *In the Matter of the S Trust and the T Trust,* echoing observations of the English judiciary in *Pitt v Holt,* made it equally clear that it will be mindful of the underlying circumstances, noting that *"there is something unattractive about the proposition that the Court should come to the rescue of foreign tax payers who, anxious to avoid paying the 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."*

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