CAREY OLSEN

Mistake or conscious risk taking?

Service area / Dispute Resolution and Litigation, Trusts and Private Wealth
Legal jurisdiction / Jersey
Date / April 2022

Representation of A re the E Settlement [2022] JRC 52
Royal Court of Jersey, 28 February 2022
Sir William Bailhache, Commissioner, Jurats Ramsden and Cornish

In a recent decision, the Royal Court has expressed reluctance to grant relief on the grounds of mistake in circumstances where, rather than a settlor being unaware of and therefore mistaken as to the risks of a transaction, the settlor has taken risks in accordance with advice but misjudged the extent of those risks.

The settlor was born and raised in the UK and had an English domicile of origin. He left the United Kingdom in 1959, living in Papua New Guinea and Australia until 1993 when he returned to the UK. In 1996 the settlor applied for and in 1998 he received confirmation from HMRC that it did not regard him as being UK-domiciled at that time. He continued to reside in the UK thereafter.

The settlor took professional advice in around 2007 in the wake of proposed changes to the UK non-domiciled tax regime. Around that time, two UK land transactions were proposed involving a company owned by the settlor. The settlor was advised to settle the shares in the company on trust prior to 5 April 2008, on the basis that the trust structure would confer significant tax advantages. A declaration of trust was made on 2 April 2008. The shares were settled on trust and the land transactions proceeded. It is not apparent from the judgment that any detailed advice was given as to the settlor's domicile at the relevant time, albeit the settlor's lawyer expressed the view that "*HMRC accepted [the Settlor] was non-domiciled at the end of 1990s, as I recollect. I think it would be all but impossible for them to go back on that*".

In April 2021, following domicile inquiries by HMRC and an investigation, HMRC notified the settlor of its conclusion that he had retained his domicile of origin at all times, or alternatively that his domicile of origin had revived before 2008. If HMRC's analysis was correct, this could have resulted in substantial and "*potentially catastrophic*" tax liabilities for the settlor. The settlor consequently applied to the Royal Court under Article 11 and/or Article 47E of the Trusts (Jersey) Law 1984 to have the declaration of trust set aside on grounds of mistake on the basis that he failed to recognise that HMRC might be able to reopen the question of his domicile.

The Court, applying its "well-settled" approach, considered the facts of the case against the following three questions:

1. Was there a mistake on the part of the settlor in relation to the establishment of the trust or the transfers of assets into trust?
2. Would the trust or transfers into trust not have been made but for the mistake?
3. Was the mistake of so serious a character as to render it just for the Court to make declaration?

The Royal Court "*with some hesitation*" ultimately concluded that those three criteria were satisfied in this case such that it was appropriate to exercise its discretion to grant the relief sought.

Of particular interest are the comments made by the Court which reflect a developing line of distinction between a settlor who takes calculated (but, with the benefit of hindsight, misjudged) risks in making tax arrangements as compared with a settlor who is genuinely unaware of (and therefore mistaken about) the risks he or she is undertaking. The Court

reiterated concerns it has expressed in previous cases about granting relief to settlors in the former position, holding that:

> *"In the former case, there should be no sympathy for such a settlor. He gambled and lost. In the latter case, the Court, as demonstrated by the authorities, looks with more sympathy on such a settlor because although his motivation – saving tax – remains the same, he carries no personal culpability, albeit his professional advisers probably do. The approach which this Court has taken on many occasions in the past has been to relieve the settlor in the latter case from having to engage in risky litigation alleging negligence against professional advisers, with all the difficulties which may be incurred either with prescription, liability, or remoteness of damage."*

The Court was particularly sceptical of the suggestion that the settlor, plainly a successful businessman aware of the significance of his domicile to his tax affairs, could consider that HMRC's confirmation in 1998 would continue to hold good and could not be revisited in 2008 when his circumstances had changed substantially. However, the Court ultimately accepted with hesitation that the settlor had not been advised about, and was therefore mistaken about, the possibility that HMRC would assert that his domicile of choice might have been lost and proceeded to grant relief.

Previous cases involving mistaken appreciation of risk

This decision follows on from previous cases where the Court has set aside transfers to trust on the grounds of mistake as to the settlor's domicile.

In Q v Lutea Trustees Limited and Others [2021] JRC 166, reliance by the settlor on advice from tax advisers as to his domicile was accepted to be mistaken, notwithstanding that the settlor appreciated as a result of that advice that there was slim risk he might be considered to have reacquired English domicile. The Court accepted that the settlor was not aware of any risk that HMRC would consider he had retained his domicile of origin, which was sufficient to establish a mistake. However, the Court also considered that the settlor's belief (formed in reasonable reliance on the advice he received) as to the extent of the risk that he would be considered to have reacquired UK domicile was so far removed from a realistic assessment of that risk that it can be described as mistaken. It is clear from the judgment that the extent of the advice taken by the settlor in that case was considerably more extensive than that taken in the instant case.

The potential relevance of conscious risk taking emerged in an earlier case, where the Court refused relief: In the matter of the B Life Interest Settlement [2012] JRC 229, our summary of which can be found here. The transaction in that case had been entered into by the trustee in order to mitigate UK inheritance tax and was made on the basis of extensive professional advice, but would only be effective in mitigating IHT if the settlor survived for a period of 7 years from the date of the appointment. The settlor (who was 57 at the time) was diagnosed with an aggressive form of Alzheimer's disease shortly after the appointments were made and died before the expiry of the 7 year period, giving rise to a substantial tax liability if the transaction could not be unwound. The Trustee sought relief on the basis that it had mistakenly believed the settlor to be a healthy 57 year old man with a life expectancy that would exceed 7 years. The Court ultimately concluded that the parties had been aware of concerns over the settlor's mental function even though his condition had not been formally diagnosed. The Court was particularly troubled that life insurance had not been arranged despite that possibility having been canvassed. The parties were found to have consciously run the risk as to the settlor's life expectancy at the time the transactions were entered into. However, in contrast to the domicile cases above, the Court treated risk taking as relevant to whether it was seriously unjust to leave the transactions undisturbed, rather than to whether there had been a mistake at all.

Conclusion

These cases taken together show that it will be a question of fact and degree whether the misappreciation of the degree of risk knowingly taken is so serious as to amount to a mistake and/or justify the Court withholding relief. The judgement the Court must make in such cases comes down to fine margins, making close consideration of the evidence as to the precise extent of the awareness of the risk essential and prediction of the outcome more difficult.

The Court has also reiterated its previous expressions of distaste at coming to the aid of settlors who have made arrangements with a view to saving themselves large amounts of tax, only to find later that those arrangements were not as successful as had been contemplated. It is notable, however, that relief has not been refused on this ground, to date.

Continued

FIND US

Carey Olsen Jersey LLP
47 Esplanade
St Helier
Jersey JE1 0BD
Channel Islands

T +44 (0)1534 888900
E jerseyco@careyolsen.com

FOLLOW US

Visit our dispute resolution and litigation team at careyolsen.com

PLEASE NOTE

Carey Olsen Jersey LLP is registered as a limited liability partnership in Jersey with registered number 80.

This briefing is only intended to provide a very general overview of the matters to which it relates. It is not intended as legal advice and should not be relied on as such.