The doctrine of mistake in Guernsey

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Many jurisdictions have now adopted the equitable doctrine of mistake, but whilst the laws of those jurisdictions may share many similarities, it is important for anyone involved in a Guernsey-law trust to be familiar with how the doctrine is applied in Guernsey specifically.

This article provides a recap of the doctrine of mistake in Guernsey, including several recent judgments from the Royal Court of Guernsey which are of particular note.

What is the doctrine of mistake?

The doctrine of mistake can often provide a relatively inexpensive and efficient way to rectify a mistaken decision by a settlor, trustee or beneficiary of a trust which would otherwise result in serious consequences, such as unforeseen tax liabilities.

The doctrine is most frequently invoked to have a disposition into or out of a trust set aside by the Royal Court, usually to avoid unintended tax consequences.

When successfully invoked, the doctrine can also reduce or even entirely avoid the need for drawn-out litigation between the relevant parties and so it is a valuable tool in any trust advisor's arsenal, and one with which all parties to a trust should be familiar.

The basis for mistake in Guernsey

The Trusts (Guernsey) Law, 2007, as amended, provides that the Royal Court may rescind a trust by declaring it invalid and unenforceable on the grounds that it was established by mistake.[1]

However, unlike in other jurisdictions (such as Jersey), the doctrine of mistake has no express statutory basis in Guernsey in respect of dispositions into or out of a trust. Instead, the Royal Court has applied and developed the doctrine of mistake with reference to the English-law principles set out by the Supreme Court in *Pitt v Holt*.[2]

The test for mistake

Per Jessica Roland DB, "*The test [for mistake] put at its simplest is there must be a causative mistake of sufficient gravity. If the court finds that the transfer was a mistake the court has an equitable jurisdiction to set aside a transfer of property by a donor.*"[3]

Embellishing that slightly, the test comprises two main elements:

1. Firstly, is there a mistake which was beyond mere ignorance, inadvertence or mis-prediction?

2. Secondly, is the mistake sufficiently grave so as to make it unconscionable not to grant the relief sought?

As regards the first element, the mistake can be as to either the legal character or nature of a transaction, or some matter of fact or law which is "basic" to the transaction.

As regards the second element, this must be an objective, evaluative judgment regarding the injustice, unfairness or unconscionability of the mistake if not corrected. This will necessarily involve a close examination of the facts including the circumstances of the mistake, its centrality to the transaction, and the severity of its consequences.

Recent examples in Guernsey

The Royal Court has considered a number of applications invoking the doctrine of mistake in recent years, which have resulted in judgments of particular interest and significance:

Dervan and anor v Concept Fiduciaries Limited and ors (Judgment 38/2012; 04/2013)

In this case, which was heard prior to the decision in Pitt v Holt, the Royal Court set aside a disposition of shares in an English company into a trust which it was clear the settlor had not sufficiently understood. A second transfer, made by a company into the trust, was not set aside because the applicant was shown to have sufficiently understood that transfer.

Of particular note is the Royal Court's preliminary decision to apply English law in considering the application, being the *lex situs* of the shares. The trust was governed by English-law, the transferor of the shares lived in England and the deed by which the shares were assigned was expressed to be governed by and interpreted in accordance with English law.

Nourse v Heritage Corporate Trustees Limited and anor (Judgment 01/2015)

In circumstances similar to those in *Dervan*, the Royal Court set aside transfers of shares into a trust. As well as not sufficiently understanding the trust itself, the applicant was also unaware of the tax consequences of the transfer. Significantly, the judgment indicates that it is easier to establish that a mistake is of sufficient gravity where an applicant has transferred all or most of their wealth (in this case, his entire shareholding) rather than only some.[4]

Gresh v RBC Trust Company (Guernsey) Limited and anor (Judgment 06/2016)

The Royal Court declined to set aside an appointment made by trustees to Mr Gresh which, contrary to his understanding, caused him to be liable to UK income tax. The Court's refusal turned on the question of unconscionability. In the case, the Court found that it would not be unconscionable for Mr Gresh to keep the proceeds of the distribution when the only person who would be affected by the tax charge would be himself, distinguishing it from other cases concerning tax consequences which affected other parties, such as a spouse, children or other persons whose interests the trust in question was established to protect.

This is notable as one of the few examples of a mistake application failing in Guernsey.

Whittaker v Concept Fiduciaries Limited and anor (Judgment 15/2017)

Here, the Royal Court set aside a transfer of shares by a business owner into a "*fundamentally flawed*" tax-planning structure which, contrary to an intention to secure tax advantages for the business owner and her heirs, would have had disastrous tax implications

if not set aside. Importantly, the Royal Court distinguished between an "*artificial tax-avoidance transaction*", which may justify refusal to grant relief, and the arrangement in this particular case.

Mohsin v Standard Chartered Trust Guernsey Limited (judgment dated 3 June 2019)

The successful applicant in this case was represented by Collas Crill. The applicant was the settlor of the trust, and had made transfers to the trust based on his mistaken belief, having received advice from the respondent's associated bank's internal wealth planner, that such transfers would not attract UK inheritance tax (IHT). The successful application saved the applicant over £450,000 in IHT. It is noteworthy that the applicant's right to set aside his dispositions into trust was not impeded by the availability to him of a potential alternative claim against the respondent's associated bank in negligence.

B Trust, A v Nerine Trust Company Ltd [2019] GRC 074

This case concerned a successful application for the rectification of a trust instrument on the grounds of mistake. In its judgment the Royal Court confirmed that, "*[i]gnorance is not as such a mistake but can lead to a false belief or assumption which the law will recognise as a mistake.*" The Court was satisfied that the applicant was not required to pursue a negligence claim against his tax adviser, noting that, whilst such a claim might have existed, it could not be said to be a more practical remedy.

Sampson and ors v Estera Corporate Trustees (Guernsey) Ltd [2019] GRC 075

The Royal Court set aside the applicants' transfers of shares into a trust which were made in the mistaken belief that they would obtain tax benefits which turned out to be illusory or non-existent. Addressing the delay in bringing the application, the Court noted: "*it had inevitably taken some time for the Applicants to take their own advice as to what had happened. Initially they continued to deal with those who were responsible for the establishment of the trust … so any relevant period would only be once that relationship ended.*"[5]

In the matter of the V Trust (judgment dated 12 October 2020)

This is another case in which Collas Crill acted for the successful applicant. The Royal Court set aside the settlor's transfers to a trust based on the applicant's mistaken belief, arising from his tax adviser's incomplete advice, that such transfers would not attract UK inheritance tax, eliminating his liability for a seven-figure sum of IHT.

The decision is noteworthy in that the evidence of the mistake was unclear and the application was brought some 18 years after the mistaken disposition was made.

In the matter of the Cloudburst Trust [2023] GRC 019

In this case, the Royal Court found that the drafting of the terms of a trust did not meet the purpose for which the trust was created in that, contrary to the settlor's intentions, it failed to provide for the complete exclusion of one of the applicants from benefit. The Court therefore ordered that the trust instrument be rectified to properly exclude that applicant. In her judgment, Roland DB clarified that the standard of proof in relation to rectification cases, as with recission, is whether there had been a causative mistake *on the balance of probabilities*.[6]

A warning to trustees

The English High Court case, *In the matter of the Daxi Tech Trust*,[7] concerned a transfer into a trust of USD 16.8 million made based on incorrect tax advice from the respondent's associated bank. The result was that a supposedly tax-efficient structure left the applicant with an IHT bill of over GBP 4.6 million. A negligence action was barred for limitation and so the applicant sought to have the transfer set aside on the grounds of mistake. The applicant succeeded, with the Court finding that the reliance on the advice constituted a mistaken belief which justified the transfer being set aside. It did not matter that tax was the sole reason for the application.

Of particular note are the judge's comments regarding the bank's conduct in response to the applicant's enquiries. He found that investigations were hampered by the bank's "*slow and apparently reluctant release of information*", finding it "*rather surprising that [the bank], having given erroneous advice, did not assist [the applicant] to resolve matters with HMRC but rather appeared to have taken a defensive position*", concluding that "*[i]t shows the subsequent conduct of [the bank] in a poor light.*"[8]

Therefore, whilst trustees and their associated advisors are entitled to protect their position (and noting that, in the *Daxi Tech Trust* case, a negligence claim against the bank was time-barred), they should avoid being overly defensive or uncooperative when faced with enquiries about a potentially mistaken transfer with adverse consequences and provide timely and constructive responses. Indeed, if a mistaken transfer is successfully set aside and its consequences eliminated, the likely quantum of any damages claim brought against the trustee or their associated advisors may be reduced very significantly or limited to the applicant's costs of applying to the Royal Court to have the transfer set aside.

General pointers

As with most proceedings concerning valuable trusts and trust assets, mistake applications are often highly fact-sensitive and dependant on information and records as to the decision-making behind the mistaken transaction and the circumstances surrounding it at the time. It is therefore essential that settlors, trustees and beneficiaries alike ensure they maintain detailed and accurate records of their decisions and any professional advice.

Mistake applications are almost invariably made by non-trustees, such as a settlor looking to rescind a trust settled on erroneous advice or a beneficiary looking to set aside a distribution. Whilst there may be rare occasions where for practical purposes there is no other suitable person to bring the matter before the court, it is generally not appropriate for trustees to bring proceedings relying on their own mistake and trustees should not regard them as uncontroversial proceedings in which they can expect to recover their costs out of the trust fund.[9]

A recurring theme in mistake applications across jurisdictions is that courts have taken a dim view of mistaken transactions arising as part of "artificial" tax-avoidance schemes. However, the Royal Court of Guernsey has also repeatedly emphasised that there is no principle of public policy in Guernsey to deprive applicants of relief in respect of an application for mistake simply because they sought to avoid payment of tax in another jurisdiction.[10] That notwithstanding, in any case involving adverse tax consequences in any jurisdiction, applicants would be well-advised to demonstrate to the Royal Court that the mistaken transaction was not part of an "aggressive" tax-avoidance scheme of the like criticised by the judiciary in recent cases.

In cases involving UK tax consequences, His Majesty's Revenue and Customs (HMRC) would normally be invited to make its own representations (although it often declines to do so).

It also bears noting that whilst mistake provides a useful means to rectify a mistaken transaction, in many cases the need to bring such proceedings could have been avoided entirely had the parties sought appropriate legal and/or tax advice beforehand.

Other options

In some circumstances, it may be more appropriate to seek for a transfer to be set aside under the English-law principle from *Hastings-Bass*,[11] which was applied by the Guernsey Court of Appeal in *M v St Anne's Trustees Limited*.[12] Under the rule in *Hastings-Bass*, a transfer may be set aside where a trustee's inadequate deliberation is sufficiently serious so as to amount to a breach of duty. The test is stricter than that for mistake and the decision as to whether a transfer should be set aside, even where a breach of duty is established, remains a matter of the Court's discretion and is likely to turn on the facts specific to each case.

In the case of a potentially mistaken disposition, it is always worth checking the validity of the purported exercise by the trustee of the relevant power enabling it to make the disposition. If there is doubt as to whether the exercise of the relevant power was valid (for example, where certain formalities were not correctly observed), the disposition may be liable to be set aside by the Court without the need to invoke the doctrine of mistake. This may be preferable as the Court would usually require less information about the trustee's decision-making process, the beneficiaries' circumstances and the trust more generally than with a mistake application.

About this guide

This guide gives a general overview of this topic. It is not legal advice and you may not rely on it. If you would like legal advice on this topic, please get in touch with the author or your usual Collas Crill contacts.

References

[1] Section 11(2)(d)(i)
[2] Pitt v Holt; Futter v Futter [2013] 2 AC 108
[3] In the matter of the Cloudburst Trust [2023] GRC 019 [30]
[4] [70]: "The position of someone divesting themselves of almost the entirety of their wealth is so momentous that it follows almost automatically that it will be treated as particularly grave."
[5] [47]
[6] [66]
[7] [2021] EWHC 2573 (Ch)
[8] ibid [6], [8]
[9] Pitt v Holt [69]
[10] See the Royal Court's judgments in Nourse, Whittaker and Sampson.
[11] Re Hastings-Bass (deceased) [1975] Ch 25 (CA)
[12] Judgment 21/2018

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