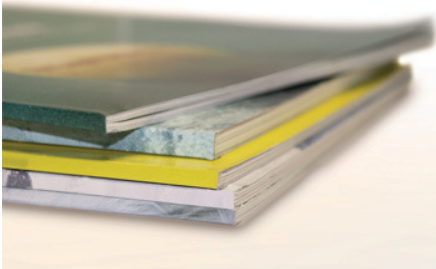


## A Case of Mistake

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**The Royal Court has recently clarified the law in relation to setting aside a trust on the grounds of mistake. The Royal Court's decision in *Re the Lochmore Trust* [2010] JRC 068, in which Appleby successfully acted for the settlor, represents a significant development of the case law in this area.**

The settlor was the beneficial owner of shares in a Jersey company and had received tax advice to the effect that the shares should be contributed to a trust. The settlor was further advised that in order to avoid an immediate charge to UK inheritance tax, the transfer should be by way of a sale (with the sale price left outstanding as a loan) rather than by way of a gift. The settlor duly acted on this advice and established a trust.

### Fundamental Misunderstanding

Unfortunately, there had been a fundamental misunderstanding between the settlor and the trustees. The settlor mistakenly thought that, in accordance with the tax advice he had received, the shares had been transferred to the trust by way of a sale. The trustees on the other hand, had simply transferred the beneficial ownership of the shares to the trust by way of a gift and had not appreciated that anything else was required.

The settlor's mistake only emerged some months later when he was advised by another tax adviser that the transaction in question had given rise to a

chargeable transfer for inheritance tax purposes, rendering the settlor liable to an immediate charge to UK inheritance tax in the sum of approximately £800,000.

The settlor applied to the Royal Court to set aside the trust on the grounds of mistake. The trustees and adult beneficiaries were convened to the hearing of the application but chose not to appear.

The power of the Royal Court to set aside a trust on the grounds of mistake is a discretionary remedy. The Royal Court referred to its previous decision in ***Re the A Trust*** [2009] JRC 245. In that case, the Royal Court concluded that the relevant test was whether the donor or settlor 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 applying that test, the court must be satisfied that the donor or settlor would not have entered into the transaction "*but for*" the mistake.

It follows that the Royal Court has to ask itself the following questions:

- (i) Was there a mistake on the part of the settlor?
- (ii) Would the settlor not have entered into the transaction "*but for*" the mistake?
- (iii) Was the mistake of so serious a character

as to render it unjust on the part of the donee to retain the property?

The Royal Court found that:

- (i) the settlor had quite clearly been mistaken, as he thought that the transfer had been by way of a sale when in fact it had been by way of a gift;
- (ii) he would not have agreed to establish the trust and contribute the shares to the trust “*but for*” the mistake;
- (iii) the mistake was of so serious a character as to render it unjust on the part of the trustees and beneficiaries to retain the property.

For these reasons, the Royal Court declared, in accordance with Article 11 of the **Trust (Jersey) Law 1984**, that the trust was established by reason of mistake and was therefore invalid.

The Royal Court’s decision in this case is significant and the threefold test set out above now represents a clear and definitive position of the law in Jersey.

What is to be welcomed is the fact that it is no longer necessary to seek to draw the problematic distinction between a mistake as to the “*effect*” of a transaction and a mistake as to the “*consequences*” of a transaction, as was previously the position under Jersey law. Therefore, future applications to set aside trusts on the grounds of mistake should be relatively straightforward in terms of preparation and determination.

### **Clear and Unequivocal Evidence**

However, in preparing for such an application, it is of crucial importance to have clear and unequivocal evidence of the settlor’s mistake. There should be an affidavit provided by the settlor in support of the application which should clearly set out the background and reasons for the mistake. Further, it is also strongly recommended that separate affidavit evidence is obtained from the settlor’s tax adviser so that the Royal Court is made aware of the fiscal consequences of the mistake. This will not only strengthen the likely chance of success of an application but will also enable the Royal Court to reach a fair decision in the interests of justice.

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