In the matter of the S Trust and the T Trust: Mistake

May 2016

The Settlors of two Jersey law trusts sought orders from the Royal Court that the transfer of money into those trusts be set aside on the grounds of mistake under Article 11 of the Trusts (Jersey) Law 1984 ("**the 1984 Law**") and the trusts be declared void. The underlying facts of both trusts are very similar. In each case, the Settlor's intentions were to minimise their respective liability to inheritance tax ("**IHT**").

In the case of the S Trust, this was to be achieved by passing on their main capital assets, namely property in the UK, to their children on the Settlor's deaths, free of IHT. The Settlors borrowed approximately £4.2 million from a private bank, whose lending was secured by a mortgage over the property. The mortgage was on interest only roll-up terms, the remaining amount, once the existing mortgage was discharged was transferred into the S Trust. With the T Trust, the Settlor's borrowed 95% of the value of their property (the equivalent of £4.75 million in Swiss Francs) from the same private bank, the lending of which was secured by a charge over that property. The mortgage and interest payments being rolled up and not repaid until the death of the survivor. The borrowed sum was transferred into the T Trust.

Rather than proving to be effective schemes for avoiding IHT liabilities, the schemes proved to be "fiscal disasters." In fact, the transfers, triggered the following:

1. an immediate 20% IHT charge over and above the nil rate band;
2. the sums transferred were subject to the relevant property regime for IHT purposes, and consequently subject to 10 yearly charges following the settlements;
3. were the trustee to have transferred assets from the Trusts, those transfers would have given rise to exit charges; and
4. the effect of the Finance Act 1986, was such that the trust properties were not enjoyed to the exclusion or virtually to the entire exclusion of the Settlors, by virtue of their continuing to reside there, and as a result, if the Trusts remained in place with those assets in it, not only would the 20% IHT entry charge, and 10 yearly charges apply, but the Settlors would also be deemed to be beneficially entitled to the Trusts assets for IHT purposes and the whole purpose of the schemes would be defeated.

The Settlors separately made applications to the Royal Court under Article 11 of the 1984 Law in order to have the Trusts set aside because they were established by mistake, and be declared void or voidable and of no effect.

Following the now established three part test for mistake, which was confirmed in In the matter of the Lochmore Trust, the Court held

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that the Trusts be set aside on the grounds of mistake and declared to be of no effect. Although W J Bailhache distanced the Royal Court from the authorities on which HMRC relied, namely Pitt v Holt and Futter v Futter and in applying the "but for" test reflected in Article 47E(3)(b) of the 1984 Law, he disagreed with the Revenue who said that the Settlors' mistakes were not basic to the transaction. In fact, said the Court, it was fundamental to the transactions, because, "but for their mistakes, the transactions would never have occurred." Despite all of this, the Court was "wary of coming to the rescue of foreign tax payers who, anxious to avail paying the contribution towards the outgoings of their own jurisdictions government, and then meet their own obligations as citizens of that jurisdiction, make schemes of this nature."

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