[2015 Gib LR 151]

S. BRUCE and C. BRUCE v. SG HAMBROS BANK (GIBRALTAR) LIMITED, SG HAMBROS BANK (CHANNEL ISLANDS) LIMITED and A. BRUCE

SUPREME COURT (Dudley, C.J.): March 20th, 2015

Trusts—mistake—incorrect legal advice to settlor—trust to be set aside for settlor's factual or legal mistake, ignorance, inadvertence or misprediction insufficient; unjust/unconscionable for donee to retain property; mistake about tax implications sufficient if no artificial tax avoidance—court to assess gravity of mistake through close examination of facts and apply objective test in considering significance of mistake and seriousness of consequences

The claimants sought to have a trust set aside on the ground of mistake.

The claimants were both the settlors and named beneficiaries of a discretionary trust. The first defendant had provided professional trustee services for approximately 12 years before it was replaced by the second defendant. The third defendant was the son of the claimants and a named beneficiary of the trust.

The claimants decided to retire to Spain and become resident taxpayers there. Once they had moved to Spain, they sought advice from the first defendant on minimizing or eliminating their obligation to pay UK taxes, particularly inheritance tax. The first defendant suggested that they create a discretionary trust and advised them that, if they transferred their assets to that trust, the moneys in the trust would not attract UK inheritance tax as long as they remained alive for seven years after settling the trust. The claimants treated those statements as authoritative and settled the trust on that basis.

Ten years later, the claimants became aware that those statements were mistaken and the true position was that, at the time that the trust was settled, they were UK-domiciled, the transfer of moneys into the trust fund constituted a chargeable transfer for the purposes of the UK Inheritance Act 1984, the UK-based trust assets were subject to a 10-year charge, and the distributions made each year were subject to exit charges, with the result that the claimants would have a total liability to H.M. Revenue & Customs of £159,848.90 plus interest of £35,169 and any further penalties which could be imposed.

The claimants sought to have the trust set aside for mistake in that they had settled it on the basis of an incorrect understanding of the tax implications of doing so and, if they had known the true position, they

would not have done so. The third defendant supported the claim to set aside the trust.

The first and second defendants admitted that the claimants established the trust labouring under a mistake and did not object to the trust being set aside, but they denied acting in any advisory capacity in relation to matters of UK inheritance tax or taxation generally.

Held, setting aside the trust:

(1) The following principles applied when exercising the court's equitable jurisdiction to set aside a non-contractual voluntary disposition for mistake: (a) the settlor must have been acting under a mistake as opposed to ignorance, inadvertence or misprediction; (b) the mistake could have been of fact or of law; (c) the mistake must have been sufficiently serious to render it unjust or unconscionable for the donee to retain the property; (d) the gravity of the mistake would be assessed by a close examination of the facts; (e) whether to leave a mistaken disposition uncorrected had to be judged according to an objective test under which the court would consider the distinct mistake, its significance in the context of the transaction and the seriousness of its consequences; and (f) a mistake as to tax implications could suffice, although in some cases of artificial tax avoidance, public policy considerations could lead to relief being refused (para. 17).

(2) The claimants and the first defendant settled the trust under a distinct mistake in that they all believed that, provided the claimants survived for seven years post-settlement, the assets transferred to the trust would not attract UK inheritance tax and, but for that mistake, they would not have established the trust. The mistake was very serious because the fundamental purpose of the trust was to mitigate against UK inheritance tax liability but instead its effect had been to create an immediate liability and diminish the value of the trust assets by 20%. Further, upon the claimants' death, the third defendant would have to pay Spanish inheritance tax on the trust assets. The trust was not an artificial tax avoidance arrangement but rather a legitimate way of mitigating tax liability given the claimants' desire to start a new life in Spain, establish a domicile of choice in that jurisdiction and meet their tax obligations there. In these circumstances, it would be unconscionable and unjust to leave the mistake uncorrected, and the trust would therefore be set aside (paras. 18–19).

Cases cited:

(1) *Hastings-Bass, In re*, [1975] Ch. 25; [1974] 2 W.L.R. 904; [1974] 2 All E.R. 193; [1974] S.T.C. 211, referred to.

(2) *Pitt* v. *Holt*, [2013] 2 A.C. 108; [2013] 2 W.L.R. 1200; [2013] 3 All E.R. 429; [2013] S.T.C. 1148; [2013] B.T.C. 126; [2013] UKSC 26, applied.

D. Feetham for the claimants;
R. Triay and *Sir Peter Caruana, Q.C.* for the first and second defendants;
K. Azopardi, Q.C. for the third defendant.

1 **DUDLEY, C.J.:** In these proceedings, the claimants, Mr. and Mrs. Bruce, who are the settlors and also two of three named beneficiaries of a discretionary trust known as the Mansepool Trust, established by a deed of settlement dated September 26th, 2003, seek to have the trust set aside on the grounds of mistake. The first defendant (Hambros Gibraltar), which at all material times provided private banking, wealth management and professional trustee services, was appointed as trustee of the Mansepool Trust. By a deed of retirement and transfer dated July 3rd, 2012, Hambros Gibraltar retired as trustee and the trust fund was transferred to the second defendant (Hambros Channel Islands), which was appointed as the new trustee. I refer to them jointly as "Hambros."

2 The third defendant, Alex, is a minor and the son of the claimants. He was served with the papers in this action pursuant to an order made by me on January 7th, 2015. Alex supports the claim to set aside the trust on the grounds of mistake and, further, he counterclaims against Hambros, seeking a declaration that the trust be set aside in accordance with the rule in *In re Hastings-Bass* (1) because the trustees failed to consider or take account of the fiscal consequences under English law of the settlement of moneys into the Mansepool Trust.

3 At the trial, I raised my concern as to the appropriateness of allowing Mrs. Bruce to act as Alex's litigation friend in circumstances in which, albeit technical, there is nonetheless a conflict of interest between their positions, in that the setting aside of the Mansepool Trust results in Mr. and Mrs. Bruce reacquiring legal and beneficial ownership of the trust assets but extinguishes Alex's discretionary interest. Whilst remaining of the view that it would have been desirable to have had someone else act as his litigation friend, I acknowledged (i) the family bond; (ii) that he is her only child; (iii) that it is apparent that Mrs. Bruce has Alex's best interests at heart; (iv) that Mr. and Mrs. Bruce have made mutual wills of which Alex is the main beneficiary following both their deaths; (v) that Alex is of an age that his views can properly be taken into account; (vi) that he has had the benefit of independent legal advice; and (vii) if the Mansepool Trust is not set aside, it will lead to a reduction of the assets available to the family unit. For those reasons, and having formed the view that it was highly unlikely that another litigation friend would seek to oppose the claim, I was persuaded to allow Mrs. Bruce to continue in that role.

4 These proceedings were started as Civil Procedure Rules, Part 7 proceedings. By its defence, Hambros admits that the claimants entered into the deed of settlement labouring under a mistake and does not object to the Mansepool Trust being set aside. However, it denies having acted in

any advisory capacity on matters of UK inheritance tax or matters of taxation generally. It has filed no witness statements in support of the defence, which is not endorsed with a statement of truth. However, the defence to Alex's counterclaim, which is endorsed with a statement of truth, repeats the paragraphs of the defence which set out Hambros's version of events. It is only to that very limited extent that Hambros has placed evidence before the court. One may speculate as to the trustee's reticence to do so or to expose its officers or former officers to cross-examination, but in a case such as this, in which this court is enjoined by the judgment of Lord Walker in *Pitt* v. *Holt* (2) ([2013] 2 A.C. 108, at para. 126) to assess the gravity of the mistake by a close examination of the facts, more is to be expected from licensed professional trustees.

5 By letter dated October 23rd, 2014, the claimants notified H.M. Revenue & Customs ("HMRC") of the proceedings and enquired as to whether it wished to apply to join the proceedings either as an interested party or otherwise. In the event, although HMRC replied by letter dated January 7th, 2015, Mr. Feetham only became aware of that reply on the day of the trial and, following discussions between them over the lunch adjournment, the position adopted by HMRC was that it was reluctant to ask Mr. Feetham to seek an adjournment, but asked that the court consider in detail the judgment of Lord Walker in *Pitt* v. *Holt.*

Background

6 Mr. and Mrs. Bruce attended the trial, gave evidence and were cross-examined. Evidence was also given by Ms. Angela White, a qualified ACCA accountant who specializes in UK and Gibraltar tax. Alex was present but, given the terms of his witness statement and the fact that his evidence could not assist in determining whether the Mansepool Trust had been established as a consequence of a mistake, I indicated that it was unnecessary for him to testify and I accept his evidence as contained in his witness statement. On the basis of the evidence before me, I find the following facts.

7 Mr. and Mrs. Bruce married in July 1977 and, after each enjoying successful careers, in or around 2001 they decided to retire to Spain and become tax residents in that country. Their wish was to sever their links with the United Kingdom and achieve non-domicile status as soon as possible. In 2002, they opened current and deposit accounts with Hambros Gibraltar, they closed all their UK bank accounts and transferred all their assets to Gibraltar and Spain. In January 2003, they moved to Spain permanently and became ordinarily resident in Spain for all purposes, including tax.

8 In the summer of 2003, they attended a number of meetings with representatives of Hambros Gibraltar, in particular with Paul Tapsell, who

was their private banker/relationship manager, and Charles Gomez, the then trust officer. Given that Mr. and Mrs. Bruce had become liable to Spanish taxes, essentially what they wanted to achieve was to minimize or eliminate any obligation to pay UK taxes such as inheritance tax. According to Mr. and Mrs. Bruce, Mr. Gomez suggested the creation of a discretionary trust and they were advised by him that, if they transferred their assets to the trust, they would be able to take periodic payments for expenses and the moneys in the trust would attract zero UK inheritance tax so long as they remained alive for seven years post-settlement.

9 In respect of representations as to the UK tax implications of the trust, the case for Hambros is that Mr. Gomez "cannot recall ever giving such specific information as alleged by the claimants." The absence of a positive case and any witnesses to expand upon it is to be contrasted with that of the claimants, who were subjected to reasonably comprehensive cross-examination as to the nature of the advice given by Messrs. Tapsell and Gomez. Mrs. Bruce accepted that the bank was not tax adviser and, when referred to Hambros Gibraltar's "Confidential Questionnaire," readily acknowledged the provision by which Hambros made clear that it did not provide legal or taxation advice in connection with the establishment of a trust. However, without difficulty I accept Mrs. Bruce's evidence that they relied upon the statements made by a trust specialist with Hambros as being authoritative. Indeed, her evidence is consistent with an internal Hambros file note of a meeting held on June 18th, 2003, which shows that the UK tax implications were at the forefront of Mr. and Mrs. Bruce's minds and were evidently discussed:

> ". . . [W]ould the fact that they still held private pensions in the UK mean they are still UK domiciled?
>
> *Change of domicile is very difficult to lose. They must sever all their UK links.*
>
> If, after 3 years, they are UK non-dom, how does this affect the IHT situation in years 3–7?
>
> *The 7 year rule would be applied on a sliding scale basis.*
>
> One way they had previously been advised to structure was to have a life interest trust for years 0–3 until they consider they are non-UK domiciled and then to convert to a discretionary trust.
>
> *This relates to persons who have been deemed UK domicile and then wish to shed that status. If they are UK domiciled, though non-residents, PET's would be subject to the 7 year rule but in any case without the trust their worldwide assets would be subject to IHT."*

10 Moreover, some time in November 2003, some two months after establishing the trust and before transferring £996,568 into the trust fund, Mrs. Bruce sent an email to Hambros Gibraltar on the following terms:

> ". . . I want to be sure for one more time that I have completely understood the tax treatment of this trust. Could you reiterate for me one more time exactly what the UK and Spanish tax status and treatment is please? Re the UK, I'm specifically concerned to know whether the UK tax rules say that for anything transferred to the trust over the nil rate band we are technically incurring a tax charge right now. Is that correct?"

11 The inheritance tax liability issue was raised by Hambros Channel Islands in late 2013. Given that the trust had been in existence for 10 years, like Mrs. Bruce I draw the inference that, when the Mansepool Trust was established, Hambros was mistaken as to the UK tax implications.

12 In my view, it would be difficult to countenance circumstances in which professional trustees could establish a trust for clients without engaging in a discussion as to its tax implications with either the clients or their advisors. Whether or not, given the provision in the application form to the effect that it was not providing legal or taxation advice, the representations by Hambros's officers can found a cause of action is not a matter which falls to be determined in these proceedings.

13 In fact, at the time that the Mansepool Trust was established and moneys transferred into the trust fund, Mr. and Mrs. Bruce were UK-domiciled and, for the purposes of the UK Inheritance Act 1984, the payment of the moneys constituted a chargeable transfer, the UK-based trust assets were subject to a 10-year charge, and the distributions made each year were subject to exit charges.

14 According to Ms. White, whose evidence I accept, the Mansepool Trust has resulted in the following liabilities to HMRC:

(a) chargeable life time transfer—£97,313.60 plus interest of £33,182.00, together with possible penalties;

(b) exit charges—£5,152 plus interest of £696; and

(c) 10-year charge—£57,382.50 plus interest of £1,291.11.

Therefore, if the Mansepool Trust is not set aside, there will be a total liability to HMRC of £159,848.90, plus interest of £35,169, plus any further penalties which could be imposed. Of some significance is Ms. White's evidence that, had Mr. and Mrs. Bruce established an interest in possession trust rather than a discretionary trust, a settlement into such a trust would have been treated as a potentially exempt transfer for UK

inheritance tax purposes and would have had the tax mitigation effect that they believed the Mansepool Trust was to have.

15 It is noteworthy that Mr. and Mrs. Bruce have declared all the assets held by the Mansepool Trust to the Spanish tax authorities as if they were held by them legally and beneficially, and there is evidence in the form of a letter from their accountants showing that they have paid taxes thereon for the years 2008 to 2012. The revocation of the Mansepool Trust will therefore have no impact as to how its assets are treated in Spain for tax purposes. It is of particular relevance that, upon Mr. and Mrs. Bruce's death, irrespective of whether the Mansepool Trust is set aside, the beneficiary under their wills, at present Alex, will be liable to pay Spanish inheritance tax. Essentially, therefore, setting the trust aside will not avoid the payment of tax on the underlying assets but rather will avoid them being taxed twice over.

16 If Mr. and Mrs. Bruce had not been acting under a mistake in relation to the UK tax implications of establishing a discretionary trust, they would not have established or settled their assets in the Mansepool Trust.

Discussion

17 The principles which apply when exercising the equitable jurisdiction of the court to set aside a non-contractual voluntary disposition for mistake were set out in the judgment of Lord Walker in *Pitt* v. *Holt* (2), with which the other members of the UK Supreme Court agreed. In the context of the present case, the applicable principles can be summarized as follows:

(a) the settlor must have been acting under a mistake as opposed to ignorance, inadvertence or misprediction;

(b) the mistake may be of fact or of law;

(c) the mistake must be sufficiently serious as to render it unjust or unconscionable for the donee to retain the property;

(d) the gravity of the mistake must be assessed by a close examination of the facts;

(e) the injustice of leaving a mistaken disposition uncorrected is an objective test. In undertaking that evaluation, the court must consider the distinct mistake, its significance in the context of the transaction and the seriousness of its consequences, and evaluate whether it would be unjust to leave the mistake uncorrected; and

(f) a mistake as to the tax implications may suffice, although in some cases of artificial tax avoidance, public policy considerations may lead to relief being refused.

18 It is apparent that Hambros Gibraltar and Mr. and Mrs. Bruce executed the deed of settlement in September 2003 under a distinct mistake. They all believed that, provided Mr. and Mrs. Bruce survived for seven years post-settlement, the assets transferred to the Mansepool Trust would attract zero UK inheritance tax and, but for that mistake, Mr. and Mrs. Bruce would not have established the trust. The mistake was undoubtedly very serious in that the fundamental purpose of establishing the Mansepool Trust was to mitigate against UK inheritance tax. Instead, the effect was to create an immediate liability and diminish the value of the assets by some 20%. This is without ignoring that, upon Mr. and Mrs. Bruce's death, their beneficiary (in all likelihood, Alex) will, in any event, have to pay Spanish inheritance tax upon the trust assets. If only by analogy, it is worth noting that, in *Pitt* v. *Holt*, the mistake resulted in a total tax liability (together with interest and penalties) of between £200,000 and £300,000 in respect of a settlement of £1.2m. Of some relevance is the fact that the Mansepool Trust was not an artificial tax avoidance arrangement but rather a legitimate way of mitigating tax given Mr. and Mrs. Bruce's desire to start a new life in Spain, establish a domicile of choice in that jurisdiction and meet their tax obligations there.

19 Taking account of all the circumstances and in the round, it would be unconscionable and unjust to leave the mistake uncorrected and the appropriate relief must be that the deed of settlement dated September 26th, 2003 made between Mr. and Mrs. Bruce and Hambros be set aside. Given my determination, it is unnecessary for me to consider whether the Mansepool Trust should also be set aside in accordance with the rule in *In re Hastings-Bass* (1).

20 Orders accordingly and I shall hear the parties as to costs.

Orders accordingly.