[2023 Gib LR 190]

IN THE MATTER OF THE STERNBUCH FAMILY NO. 1 TRUST

FINSBURY TRUST COMPANY LIMITED (as trustee of the STERNBUCH FAMILY NO. 1 TRUST) v. ESTATE OF MORGENSTERN (deceased)

SUPREME COURT (Restano, J.): February 24th, 2023

2023/GSC/010

Trusts—mistake—setting aside distributions for mistake—distributions made in separation of two families' assets in mistaken belief that no adverse tax consequences set aside—serious and unexpected UK tax liability

A trustee sought to set aside distributions.

The claimant was the trustee of the Sternbuch Family No. 1 Trust. The trust had been set up by Mr. Sternbuch in 1991 and his grandchildren were the ultimate beneficiaries. Mr. Sternbuch died in 1997. Over the years, a Mrs. Morgenstern and her family had invested in property together with the trustees of the trust. Although the funds were not properly segregated, a proportion of the trust assets were later notionally earmarked for the benefit of the Morgenstern family. The total value of the trust was around £20m. consisting of cash and shares in Gibraltar registered companies, some of which were beneficially entitled to UK residential property or shares in companies which held UK residential property.

In 2018, Mrs. Morgenstern relocated from the UK to Israel. As a new Israeli resident, she was exempt from Israeli tax on non-Israeli income for a 10-year period. In light of this beneficial Israeli tax status, she proposed a restructuring of the trust which would separate the trust assets which had been notionally earmarked for the Morgenstern family from those held for the benefit of Mr. Sternbuch's grandchildren. The proposed restructuring was designed to proceed in accordance with a step plan: (1) Mrs. Morgenstern was to be added as a discretionary beneficiary of the trust; (2) the assets held in the trust were then to be appointed to her; (3) she would then settle the assets she received onto two new trusts, one for the Morgenstern family and one for the Sternbuch family, which would separate the assets earmarked for the two branches of the family; (4) the trustees of these new trusts would then distribute their assets back to Mrs.

Morgenstern; and (5) she would then make direct gifts to her grandchildren which it was believed ensured that US tax filing obligations would be streamlined for them.

The trustee assumed Mrs. Morgenstern had taken professional tax advice on the restructuring, although that turned out not to be the case. The restructuring went ahead and stage 1 was completed in June 2018. Advice was then obtained from UK tax advisers that as Mrs. Morgenstern had left the UK and become non-resident in the UK for tax purposes, any distribution she received would not be taxable in the UK, and she was considered domiciled in the UK and any transfer of assets by her in settling the new trusts would be potentially liable to UK IHT if she did not survive seven years after the transfer.

Mrs. Morgenstern settled the new trusts and the distributions were made to her. She then proceeded to make various gifts to her grandchildren as planned, she also received some distributions, and she settled money and shares into the new trusts. Mrs. Morgenstern died in 2020.

It subsequently became apparent that the advice from the UK tax advisers was wrong. The distribution of the trust assets to Mrs. Morgenstern and her settlement of them onto the new trusts resulted in an immediate UK IHT charge of over £4.4m. The total IHT chargeable could be as much as £11m. if the maximum penalties were applied. The claimant applied to set aside the distributions on the ground of mistake.

Held, judgment as follows:

(1) The court had jurisdiction to set aside a voluntary distribution or gift made as a result of mistake. There must be a distinct mistake, as distinguished from mere ignorance or inadvertence, which must be serious and causative. There must then be an evaluation of the justice of the situation to determine whether the gift should be set aside. It was likely that relief would not be given if the transaction was part of a tax avoidance scheme. Any third party claims must be considered, although this might not necessarily be a bar to relief being granted if it could be catered for in some other way, such as with an appropriate undertaking or indemnity. The fact that a tax liability would be reduced as a consequence of the court exercising this jurisdiction did not itself render it inappropriate to set aside a disposition on this basis. It was also important to note that the mistake did not necessarily have to be as to the direct effect of the transaction in question, it might also be as to the indirect effect (paras. 16–19; paras. 24–25).

(2) The trustee was entitled to an order setting aside the distributions on the ground of mistake. Two mistakes had been made as to the tax consequences of the restructuring: first, that the trustee believed it could transfer certain shares held in the trust to Mrs. Morgenstern without incurring any charge to UK tax, whereas in fact this gave rise to a liability to UK IHT; secondly, it believed that the distribution of the cash and shares held in the trust to Mrs. Morgenstern for her to settle them onto the new trusts would not incur any immediate charge to UK IHT, which was also wrong. The mistakes were based originally on an assumption on the part of

the trustee that the distributions would not be subject to adverse tax consequences, which was later reinforced by incorrect tax advice. The court was satisfied that if the trustee had known about this, it would not have proceeded with the appointments. The trust had not originally been liable to any UK tax charges, other than 10-yearly IHT charges in respect of the indirectly owned UK residential property. The main driver for the restructuring was to correct the issue of the mixed assets of the Sternbuch and Morgenstern families. The adverse tax consequences which flowed from the mistakes were very serious. The immediate charges were some £4.4m. and the liability could be as much as £11m. This was a large part of the trust value and would leave the beneficiaries significantly worse off. As a result of the mistakes, the grandchildren would suffer a substantial loss on the sums settled for their benefit, which would be an unjust outcome. The reduction of the tax liability brought about by the reversal of the disposition did not render it inappropriate for the court to exercise the jurisdiction. The disposition and the steps that followed were not about tax saving. The impetus was the desire to separate out the interests of the two branches of the family in a tax efficient manner taking into account Mrs. Morgenstern's move to Israel. The intention had also been to assist the grandchildren who were largely resident in the US by making a transfer to them in a manner that was less burdensome in terms of the documents that they would need to file under US law. These purposes were legitimate. The fact that the effect of the order would be to create a tax saving did not mean that the court should not exercise its discretion to set aside. The court noted that HMRC had chosen not to participate in these proceedings and inferred that HMRC did not object to the relief sought or the tax consequences which would flow from it. The fact that the assets had now been distributed should not be a bar to the availability of rescission. It would now be up to the estate to do whatever was necessary to give effect to the order provided the assets had not come into the hands of a bona fide purchaser. In any event, Mr. Sternbuch's grandchildren had consented to the relief sought and they understood the consequences if the claim were successful. The estate had also consented to the relief sought subject to the issue of the liability which it could discharge from sums it received. The trustee had addressed this by offering an indemnity to the estate up to £373,411, which was the sum which the estate received from the disposition and which it still held. The just way to proceed was for the court to order that the mistaken transactions be reversed, subject to the indemnity offered by the trustee (paras. 28–38).

(3) The result of the court setting aside the distributions was that Mrs. Morgenstern always held the shares and cash held in the trust on bare trust for the trustee. This meant that the shares which were then appointed to the trustee as trustee of the new trusts were held by it for itself as trustee of the trust. Further, the traceable proceeds of the cash, which were now primarily in the hands of the grandchildren (although there was a modest sum held by the estate) were also held by them as bare trustees for the trustee as trustee of the trust. This was all subject to the undertaking offered by the

trustee that it indemnified the representatives of the estate against any liabilities to which the estate became liable up to a maximum of £373,411. The court considered that the trustee had acted properly and reasonably and that it was entitled to an indemnity from the assets of the trust in respect of the costs and disbursements occasioned by and incidental to this claim (paras. 39–41).

Cases cited:

(1) *Abadir* v. *Credit Suisse Trust Ltd.*, [2021] EWHC 2573 (Ch); [2022] 8 WLUK 226, considered.
(2) *Anker-Petersen* v. *Christensen*, [2002] WTLR 313, referred to.
(3) *Bruce* v. *SG Hambros Bank (Gib.) Ltd.*, 2015 Gib LR 151, referred to.
(4) *Freedman* v. *Freedman*, [2015] EWHC 1457 (Ch); [2015] WTLR 1187, considered.
(5) *Goodchild* v. *Goodchild*, [1997] 1 W.L.R. 1216, considered.
(6) *Hartogs* v. *Sequent (Schweiz) AG*, [2019] EWHC 1915 (Ch), referred to.
(7) *Kennedy* v. *Kennedy*, [2014] EWHC 4129 (Ch); [2015] WTLR 837, followed.
(8) *Pitt* v. *Holt*, [2013] UKSC 26; [2013] 2 A.C. 108; [2013] 2 W.L.R. 1200; [2013] 3 All E.R. 429, followed.
(9) *van der Merwe* v. *Goldman*, [2016] EWHC 790 (Ch); [2016] 4 W.L.R. 71; [2016] WTLR 913, referred to.

Legislation construed:

Trusts (Private International Law) Act 2015, s.4(1): The relevant terms of this subsection are set out at para. 27.

A. Holden with *M. Levy* (instructed by Hassans) for the claimant;
O. Curry with *M. Trinidad* (instructed by Kenneth Navas Barristers and Solicitors) for the defendant.

1 **RESTANO, J.:**

Introduction

This is a claim where the claimant, Finsbury Trust Co. Ltd. ("FTCL") in its capacity as trustee of the Sternbuch Family No. 1 Trust ("the trust") is seeking to set aside distributions which it made on the grounds of mistake. The claim has been commenced by way of a Part 8 claim form, and it is made against the estate of the late Shirley Morgenstern ("the estate") as the distributions which lie at the heart of this claim were initially made to Mrs. Morgenstern who was one of the beneficiaries of the trust before she died. FTCL also seeks an indemnity from the assets of the trust for its costs and disbursements in this claim. The claim is supported by the first and second witness statements of William Cid de la Paz dated February 4th, 2022 and November 7th, 2022.

2 The acknowledgment of service form filed by the estate states that the claim is not contested subject to appropriate undertakings being provided by FTCL, and the views of any beneficiaries of the estate after they are fully consulted. Letters from each of the beneficiaries confirming their consent to the relief sought were also exhibited to Mr. Cid de la Paz's second witness statement.

3 Further, and for reasons which will become clear later on in this judgment, HMRC were notified about this application and have been provided with copies of the documents in the claim at its request. HMRC has neither applied to be joined as a party nor has it made any comment on the claim.

Background

4 The trust was settled by Elias Sternbuch by way of a deed dated December 19th, 1991 ("the trust deed"). The original sole trustee was Line Trust Corp. Ltd. but, on April 7th, 1994, it was replaced as trustee by FTCL. Clause 25 of the trust deed provides that Gibraltar law is the proper law of the trust.

5 The original discretionary beneficiaries named in the trust were Mr. Sternbuch's grandchildren, namely, the children of his son, the late Naftali Sternbuch ("Naftali") and his wife Vivene Sternbuch ("Vivene"). Mr. Sternbuch also provided a "letter of wishes" stating that the assets of the trust should eventually be divided between his grandchildren. This letter of wishes records Mr. Sternbuch's wishes that during his lifetime the trustee should look to him for instructions as to how to deal with the trust fund, and after his death to his son Naftali, and after Naftali's death to Vivene.

6 Naftali died of cancer in 1994 at the age of forty-three, and his widow remarried, becoming Vivene Soloff. Mrs. Soloff's mother was Shirley Morgenstern. Mr. Sternbuch died in 1997 and he was a client of James Levy, K.C., C.B.E. of Hassans. Mr. Levy recorded in a note dated October 26th, 2011 and addressed "to whom it may concern" that when Naftali was diagnosed with cancer, Mr. Sternbuch told Mr. Levy that if anything were to happen to Naftali and Vivene were to remarry, Mrs. Morgenstern should be consulted about the administration of an account held by a Liechtenstein foundation which was the precursor to the trust.

7 Over the years, Mrs. Morgenstern and her family invested in property together with the trustees of the trust. This was done with the Morgenstern family lending money to the trust which, together with trust funds, was used for various investments made by companies owned by the trust. Although these funds were not properly segregated, a proportion of the trust assets was later notionally "earmarked" for the benefit of the Morgenstern family. The total value of the trust was around £20m. consisting of cash and shares in Gibraltar registered companies, some of which were beneficially entitled

to UK residential property or shares in companies which held UK residential property. It is worth pointing out at this stage that until that point, the trust's liability to UK tax was minimal.

8 In 2018, Mrs. Morgenstern relocated from the UK to Israel. As a new Israeli resident, she was exempt from all Israeli tax on non-Israeli income for a ten-year period. In the light of this beneficial Israeli tax status, Mrs. Morgenstern proposed a restructuring of the trust which would separate the trust assets which had been notionally earmarked for the Morgenstern family from those held for the benefit of Mr. Sternbuch's grandchildren, and thus regularize matters. This restructuring would also involve distributing assets to Mr. Sternbuch's grandchildren in a way which would take into account the fact that they were mainly US citizens.

9 The proposed restructuring was designed to proceed in accordance with a "step plan" as follows:

(1) Mrs. Morgenstern was to be added as a discretionary beneficiary of the trust.

(2) The assets held in the trust were then to be appointed to Mrs. Morgenstern.

(3) Mrs. Morgenstern would then settle the assets she received onto two new trusts—the Morgenstern Family Trust and the Naftali Family Trust. This would separate the assets earmarked for the two branches of the family.

(4) The trustees of these new trusts would then distribute their assets back to Mrs. Morgenstern.

(5) Mrs. Morgenstern would then make direct gifts to her grandchildren which it was believed ensured that US tax filing obligations would be streamlined for them.

10 At that time, FTCL was operating on the assumption that Mrs. Morgenstern, as an accomplished businesswoman, had taken professional tax advice on the restructuring although, as will be seen, this turned out not to be the case. The restructuring therefore went ahead and stage one of the restructuring was completed on June 6th, 2018, when Mrs. Morgenstern was added as a discretionary beneficiary of the trust. Some advice, however, was provided to FTCL because as part of the restructuring one of the companies owned by the trust was being redomiciled from Jersey to Gibraltar, and the directors of that Jersey company requested tax advice in that context. The advice was provided by UK tax advisors, Fox Associates LLP ("Fox"), in a short letter dated July 25th, 2018 which stated, amongst other things, that (1) Mrs. Morgenstern had left the UK on May 2nd, 2018 and had become non-resident in the UK for tax purposes, and that any distribution she would receive would not be taxable in the UK; and (2) Mrs.

Morgenstern was considered domiciled in the UK, and any transfer of assets held by her in settling the new trusts would be potentially liable to inheritance tax ("IHT") if she did not survive seven years from the date of the transfer. This advice was provided after the restructuring had commenced with Mrs. Morgenstern having been added as a beneficiary of the trust, but before she settled the new trusts and the distributions were made to her, all of which took place as from September 2018. Mrs. Morgenstern then proceeded to make various gifts to her grandchildren as planned, she also received some distributions, and she settled money and shares into the new trusts as well.

11 Mrs. Morgenstern died in 2020 and David Hassan, a director of FTCL, was appointed as the sole executor of her will. As part of Mr. Hassan's review of the estate, he became concerned that the estate might be subject to UK tax liabilities. Mr. Hassan shared this concern with FTCL, advice was taken, and this confirmed that Mr. Hassan's concerns were well-founded.

12 The advice received from Fox turned out to be wrong because (1) the distribution of shares by the trustee to Mrs. Morgenstern was taxable in the UK as it was subject to an immediate IHT exit charge payable by FTCL of £430,085; and (2) the settlement of the cash and shares held in the trust were immediately chargeable to IHT in the aggregate sum of £4,014,337. The advice that the new trust would be potentially liable to IHT if Mrs. Morgenstern did not survive for seven years from the date of the transfer was not only wrong but also gave the false impression that the settlement by Mrs. Morgenstern of new trusts would be a "potentially exempt transfer" for IHT purposes.

13 The effect of this is that the distribution of the trust's assets to Mrs. Morgenstern, and her settlement of them onto the new trusts resulted in an immediate UK tax charge to IHT of £4,444,422. Mr. Cid de la Paz has described the restructuring as disastrous. A report obtained by FTCL from Fladgate LLP dated August 4th, 2022 states that the total IHT chargeable to FTCL, the trustees of the new trusts, the estate and to the ultimate beneficiaries could be as much as around £11m. if the maximum penalties are applied. Thus, counsel for FTCL said that as in an Agatha Christie novel, the starting position in which FTCL found itself was as peaceful and unspoiled as the eventual outcome was grisly. This application is therefore FTCL's way of asking the court, by means of its equitable jurisdiction, to rewrite this particular crime novel.

The position of the estate

14 Further to an order made on May 24th, 2022, Kenneth Navas was appointed to represent the estate which largely supported the application. The estate only expressed one qualification to the relief sought being

granted. This related to the fact that Mrs. Morgenstern had retained £373,411 at the time of her death from the distributions which she had received. This was relevant because there was a chance that the estate faced a tax liability in respect of a loan owed to it by a company called Ruby Properties which could be met from these funds, but which would not be available if the transaction were reversed.

15 The estate submitted that the existence of possible liabilities to third parties such as this one affected the justice of setting aside the distributions to Mrs. Morgenstern, albeit only to the extent that it would require repayment of the funds held by the estate at the time of her death. The estate's practical way of dealing with this was to request that appropriate undertaking be provided by FTCL in this regard.

Legal principles

16 The principles governing the court's jurisdiction to rescind a voluntary disposition or gift made as a result of mistake were restated comprehensively by Lord Walker in *Pitt* v. *Holt* (8), and summarized by Sir Terence Etherton, C. (as he then was) in *Kennedy* v. *Kennedy* (7) in his judgment as follows ([2014] EWHC 4129 (Ch), at para. 36):

> "(1) There must be a distinct mistake as distinguished from mere ignorance or inadvertence or what unjust enrichment scholars call a 'misprediction' relating to some possible future event. On the other hand, forgetfulness, inadvertence or ignorance can lead to a false belief or assumption which the court will recognise as a legally relevant mistake. Accordingly, although mere ignorance, even if causative, is insufficient to found the cause of action, the court, in carrying out its task of finding the facts, should not shrink from drawing the inference of conscious belief or tacit assumption when there is evidence to support such an inference.
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> (2) A mistake may still be a relevant mistake even if it was due to carelessness on the part of the person making the voluntary disposition, unless the circumstances are such as to show that he or she deliberately ran the risk, or must be taken to have run the risk, of being wrong.
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> (3) The causative mistake must be sufficiently grave as to make it unconscionable on the part of the donee to retain the property. That test will normally be satisfied only when there is a mistake either as to the legal character or nature of a transaction or as to some matter of fact or law which is basic to the transaction. The gravity of the mistake must be assessed by a close examination of the facts, including the circumstances of the mistake and its consequences for the person who made the vitiated disposition.

> (4) The injustice (or unfairness or unconscionableness) of leaving a mistaken disposition uncorrected must be evaluated objectively but with an intense focus on the facts of the particular case. The court must consider in the round the existence of a distinct mistake, its degree of centrality to the transaction in question and the seriousness of its consequences, and make an evaluative judgment whether it would be unconscionable, or unjust, to leave the mistake uncorrected."

17 To this, the Chancellor added (*ibid.*, at para. 39):

> "Lord Walker observed in *Pitt v Holt* at paragraph [135] that in some cases of artificial tax avoidance the court might think it right to refuse relief, either on the ground that such claimants, acting on supposedly expert advice, must be taken to have accepted the risk that the scheme would prove ineffective or on the ground that discretionary relief should be refused on grounds of public policy."

18 *Pitt* v. *Holt* also canvassed the issue of third party claims which is relevant given the position of the estate in this case. In *Pitt* v. *Holt* there had been a settlement of a sum awarded by way of damages on discretionary trust for the benefit of the settlor and others. Because of a failure to comply with s.89 of the Inheritance Tax Act 1984, the settlement incurred avoidable and significant tax charges. In order to deal with an argument made by HMRC that the settlement should not be set aside because the court would not know what claims would vest in the settlor's estate, a letter was provided confirming that no claims would be made against the trustees or the recipients of funds from the trustees. In this context, Lord Walker said the following ([2013] 2 A.C. 108, at para. 141):

> "Until the solicitor's letter of 22 November 2011 there was at least a possibility of third party claims arising, and the Revenue placed reliance on that as a reason for refusing relief. But for the letter, the court might, if minded to grant relief, have required an undertaking to the same effect as the one that Mrs Pitt and M. Shores have volunteered."

19 Thus, in order for relief to be given, there must be a distinct mistake which must be serious and causative. There must then be an evaluation of the justice of the situation to determine whether the gift should be set aside. It is likely that relief will not be given if the transaction is part of a tax avoidance scheme. Further, any third party claims must also be considered although this may not necessarily be a bar to relief being granted if this can be catered for in some other way, such as with an appropriate undertaking or indemnity being provided.

20 There are a number of authorities which provide useful examples of cases where gifts have been set aside. In *Kennedy* v. *Kennedy*, the application was granted for rescission of a clause in a deed of appointment

which mistakenly referred to certain shares. This had not been the intention behind this clause which was to leave the shares in the settlement to avoid a charge to capital gains tax liability and which was incurred as a result of the mistake. It was held that this mistake was causative and serious, and was contrary to the planning which had been put in place and which was designed to avoid capital gains tax. Had the trustees not been mistaken, they would have not have executed the deed of appointment. Further, it was held that this was not an artificial tax avoidance arrangement, or part of one, but rather a legitimate scheme designed for the benefit of the beneficiaries. As a result, the court held that it would be unconscionable in principle to leave the appointment uncorrected and the relevant clause in the deed of appointment was set aside.

21 *Freedman* v. *Freedman* (4) provides another example of this jurisdiction being successfully invoked, and where the court applied *Pitt* v. *Holt* (8) and *Kennedy* v. *Kennedy* (7). In that case, a settlement was set aside based on incorrect tax advice provided to the settlor's father and which the settlor had seen. Based on that advice, the settlor said that she understood that there would be no adverse tax consequences for her entering into the settlement which was wrong because the solicitor who had provided that advice had failed to advise that there would be a lifetime chargeable transfer for inheritance tax purposes with additional ten-yearly and entry and exit charges.

22 Yet another example with facts which are even more similar to the present case is *Abadir* v. *Credit Suisse Trust Ltd.* (1). In that case, a disposition of money to a Guernsey law trust caused an individual who believed himself to be UK non-domiciled, but who was in fact UK deemed domiciled, to trigger an unanticipated IHT charge. The judge in that case held that there had been a sufficiently serious mistake causing significant tax consequences for the trust and which justified the setting aside the transfer. Another example of a similar case where a gift was set aside for mistake and where the parties were unaware of the tax consequences of a transaction is *van der Merwe* v. *Goldman* (9).

23 This court has also adopted the same approach as the English courts. In *Bruce* v. *SG Hambros Bank (Gib.) Ltd.* (3), Dudley, C.J. set aside the establishment of a trust, the settlement of which was mistakenly believed by the settlors to be a "potentially exempt transfer" for the purposes of UK IHT, but which in fact constituted an immediately chargeable transfer.

24 It is clear from these authorities that the fact that a tax liability would be reduced as a consequence of the court exercising this jurisdiction does not itself render it inappropriate to set aside a disposition on this basis. This is consistent with the general proposition of law set out by Morritt, L.J. in *Goodchild* v. *Goodchild* (5) as follows ([1997] 1 W.L.R. at 1231D–E):

> "If the order made is properly within the jurisdiction of the court the fact that it was sought with the motive of seeking to achieve a better tax position is usually irrelevant: *In re Sainsbury's Settlement (Practice Note)* [1967] 1 W.L.R. 476. But where the effect of the order is to confer a substantial advantage on the parties at the expense of the revenue it is in my view important that the court should be satisfied that the order is not only within its jurisdiction but also one which may properly be made."

25 It is also important to note that the mistake does not necessarily have to be as to the direct effect of the document in question, it may also be as to the indirect effect of that document. *Lewin on Trusts*, 20th ed., para. 4–067, at 139–140 (2020) states as follows:

> "We also consider that a disposition can still be set aside where the mistake is not as to the first step in a series of transactions, but as to a step which is intended to be carried out pursuant to that first step."

26 As for the proprietary consequence of an order setting aside a disposition, this is explained in *Snell's Equity*, 34th ed., at para. 15–020, at 462–463 (2019), as follows:

> "Where a transaction is rescinded in equity, but its order the court will provide for the re-vesting or restoration of title and for delivery up of possession, directing that the defendant do whatever is necessary for these purposes, again provided the asset has not come into the hands of a bona fide purchaser . . ."

Discussion

27 There is no question that the court has jurisdiction to deal with this claim. As stated above, the trust deed provides that Gibraltar law is the proper law of the trust. Under the Trusts (Private International Law) Act 2015, the court will apply Gibraltar law to:

> "any question in respect of a Gibraltar trust concerning—
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> . . .
>
> (f) the relationships between the trustees and the beneficiaries . . . [and]
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> (g) the distribution of trust assets."

28 Applying the equitable rules set out above to the facts of this case, one must first consider whether there was a distinct mistake made. There were two mistakes made here as to the tax consequences of the restructuring. The first was that FTCL believed that it could transfer certain shares held in the trust to Mrs. Morgenstern without incurring any charge to UK tax. In fact, this gave rise to a liability to UK IHT. The second mistake concerned

the belief that the distribution of the cash and all the shares held in the trust to Mrs. Morgenstern for her to settle them onto the new trusts would not incur any immediate charge to UK IHT. This was also wrong. While the tax liability in relation to the second mistake related to a subsequent step in the restructuring, this restructuring consisted of a series of steps and the purpose of the initial distributions was for the subsequent steps in the restructuring to be carried out. As the passage in *Lewin on Trusts* states, the fact that this liability was the indirect effect of the mistake is not a bar to the grant of relief. This is further illustrated by one of the cases cited by *Lewin on Trusts* in support of that proposition, namely *Anker-Petersen* v. *Christensen* (2). In that case, the court set aside initial assignments to a trustee because of a mistake made by the donors in respect of the subsequent resettlement of the trust fund by the trustee onto new Jersey discretionary trusts.

29 Both these mistakes were based originally on an assumption on the part of FTCL that the distributions would not be subject to adverse tax consequences, an assumption which was later reinforced by the incorrect tax advice it received from Fox. These were therefore distinct mistakes which lay at the root of the appointments, and FTCL therefore proceeded on the mistaken belief that the substantial liabilities which have been incurred would not be incurred. I am satisfied that if FTCL had known about this, it would not have proceeded with the appointments.

30 Were these mistakes sufficiently serious to render the transaction unconscionable? Mr. Cid de la Paz explained in his evidence that the trust was not originally liable to any UK tax charges as it was settled by Mr. Sternbuch who was Swiss, and whose beneficiaries were US residents. The only exception to this was the ten yearly IHT charges in respect of the indirectly owned UK residential property. Further, he states that the main driver for the restructuring was to correct the issue of the "mixed" assets of the Sternbuch and Morgenstern families. This is unchallenged evidence which is in any event inherently compelling and which I accept. The adverse tax consequences which flow from these mistakes are very serious indeed as the immediate charges resulting from them is around £4.4m., and the liability could be as much as around £11m. if penalties are applied. On any basis, this represents a large part of the total value of the trust, and which leaves the beneficiaries significantly worse off.

31 The next question is whether it is manifestly unjust, unfair or unconscionable to leave the mistakes uncorrected. The first point to bear in mind here is that the distributions were made by FTCL in its capacity as trustee of the trust but that the damage suffered as a result of the mistakes has been sustained by the beneficiaries of the trust, largely Mr. Sternbuch's and Mrs. Morgenstern's grandchildren, albeit some of the assets were earmarked for the Morgenstern family. As a result of these mistakes, the grandchildren would suffer a substantial loss on the sums settled for their

benefit by their grandfather. It seems to me that this is an unjust outcome which inclines in favour of the order sought being granted.

32 One must also consider as part of this evaluation whether the reduction of the tax liability brought about by the reversal of this disposition renders it inappropriate for the court to exercise the jurisdiction. In my view, the answer to this question is "no." The disposition and the steps that followed were not about a tax saving. The impetus was the desire to separate out the interests of the two branches of the family in a tax efficient manner taking into account Mrs. Morgenstern's move to Israel. Another factor in play was the desire to assist the grandchildren who are largely resident in the US by making a transfer to them in a manner that was less burdensome in terms of the documents that they would need to file under US law. These purposes were legitimate.

33 As the authorities set out above make clear, the fact that the effect of the order would be to create a tax saving does not mean that the court should not exercise its discretion to set aside. Having established that there is a causative mistake, the proper way to proceed in exercising that discretion is by considering the injustice, or unfairness or unconscionableness of leaving the mistake uncorrected in the round. Lord Walker put it thus in *Pitt* v. *Holt* (8) ([2013] 2 A.C. 108, at para. 128):

> "The court cannot decide the issue of what is unconscionable by an elaborate set of rules. It must consider in the round the existence of a distinct mistake (as compared with total ignorance or disappointed expectations), its degree of centrality to the transaction in question and the seriousness of its consequences, and make an evaluative judgment whether it would be unconscionable, or unjust, to leave the mistake uncorrected. The court may and must form a judgment about the justice of the case."

34 We are not concerned here with an artificial or aggressive form of tax avoidance such that would militate against the setting aside of the transfer as being against public policy. If anything, what we are concerned with here is akin to what has been described as "vanilla tax planning" (see HHJ Hodge, K.C. in *Hartogs* v. *Sequent (Schweiz) AG* (6) ([2019] EWHC 1915 (Ch), at para. 25), and cited in *Abadir* (1) ([2021] EWHC 2573 (Ch), at para. 60)). I note in this context that HMRC has chosen not to participate in these proceedings and infer from that that HMRC does not object to the relief being sought, and the tax consequences which would flow from it. In my view, therefore, the fact that the setting aside of the appointments will bring about tax benefits is not a reason to withhold relief on the grounds of public policy.

35 I have also considered that the assets have now been distributed. I do not consider that this should be a bar to the availability of rescission either. Indeed, that was the position in *Pitt* v. *Holt*, and rescission was still ordered

by the court there. As the passage from *Snell's Equity* set out above makes clear, it would be up to the estate now to do whatever is necessary to give effect to the order provided the assets have not come into the hands of a *bona fide* purchaser. In any event, Mr. Sternbuch's grandchildren have all confirmed that they consent to the relief sought, and that they understand the consequences of the claim if it is successful.

36 The estate has also consented to the relief sought subject to the issue of the liability which it could discharge from sums it received. FTCL have addressed this by offering an indemnity to the estate against any liabilities to which the estate might become liable to up to a maximum of £373,411, which is the sum which the estate received from the disposition and which it still holds. Counsel for the estate accepted that the estate could ask for no more than this, and it also seems to me that this adequately deals with this issue.

37 The proper conclusion to be drawn following a proper evaluation of all of the facts of the case is that the just way to proceed is for the court to order that the mistaken transactions be reversed, subject to the indemnity offered by FTCL.

Conclusion

38 For the reasons set out above, I consider that FTCL is entitled to an order setting aside the distributions on the grounds of mistake which include the various appointments of money and the transfer of shares to Mrs. Morgenstern.

39 The result of this is that Mrs. Morgenstern always held the shares and cash held in the trust on bare trust for FTCL. This means that the shares which were then appointed to FTCL as trustee of the new trusts are held by it for FTCL as trustee of the trust. Further, the traceable proceeds of the cash, which are now primarily in the hands of the grandchildren (although there is a modest sum held by the estate) are also held by them as bare trustees for FTCL as trustee of the trust.

40 This is all subject to the undertaking offered by FTCL that it indemnifies the representatives of the estate against any liabilities to which the estate becomes liable up to a maximum of £373,411.

41 Further, I consider that FTCL has acted properly and reasonably and that it is entitled to an indemnity from the assets of the trust in respect of the costs and disbursements occasioned by and incidental to this claim.

Judgment accordingly.