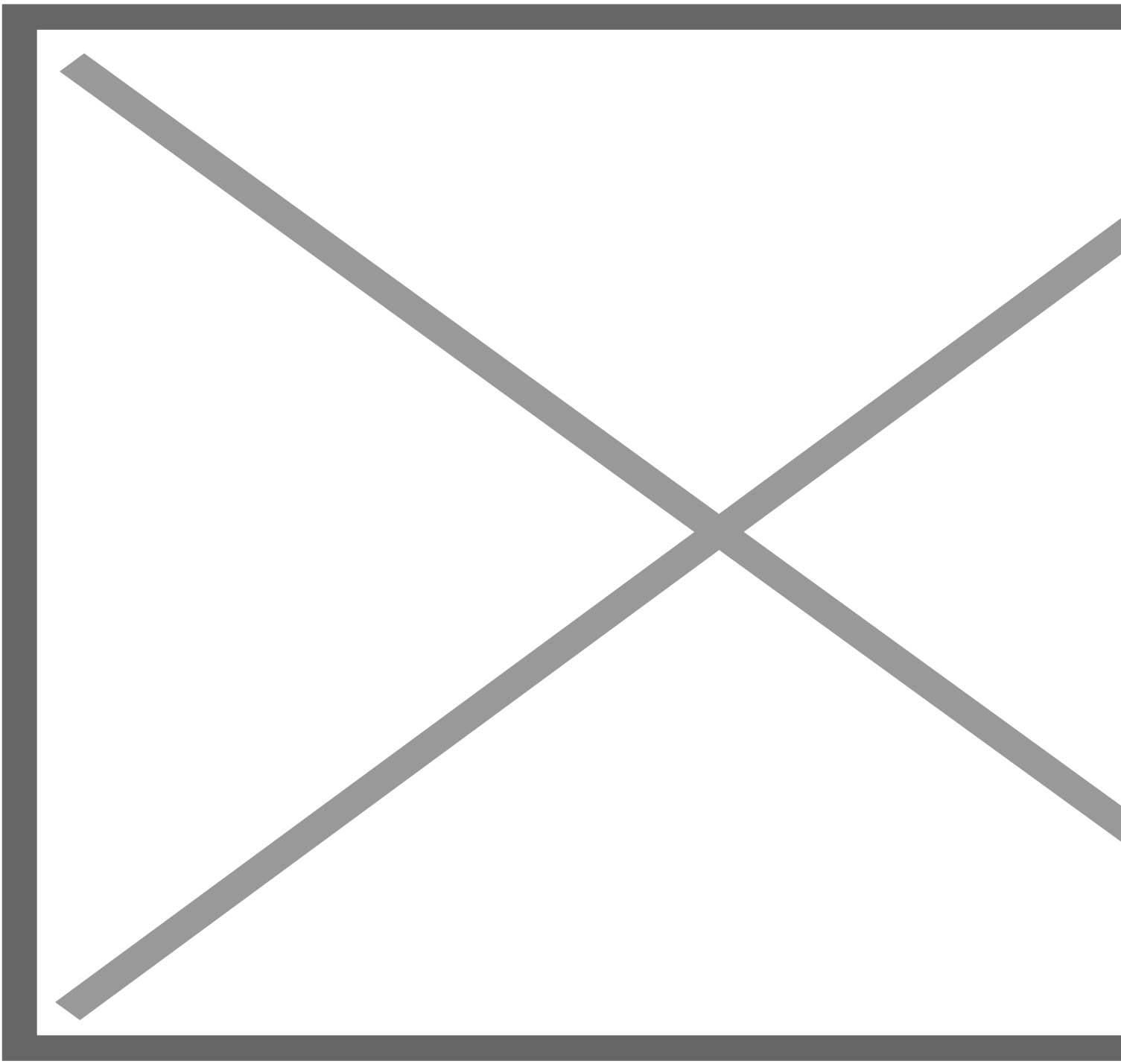
Was it a mistake?

Indirect Tax



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Sarah Smith revisits Pitt v Holt and asks when you can set aside a transaction on the grounds of mistake

Key Points

What is the issue?

Two cases concerning the court's equitable jurisdiction to set aside voluntary dispositions on the grounds of mistake have recently come before the English High Court.

What does it mean to me?

The Supreme Court's decision in Pitt v Holt [2013] UKSC 26 remains the leading authority on the rescission of a non-voluntary disposition for mistake. The gravity of a mistake will be determined by 'unconscionableness', 'injustice' and 'unfairness'.

What can I take away?

Claimants may well find themselves facing a challenge to their claim from HMRC, particularly in cases where the steps taken to mitigate tax may be considered as 'artificial tax avoidance' and contrary to public policy.

Within a matter of months, two cases concerning the court's equitable jurisdiction to set aside voluntary dispositions on the grounds of mistake came before the English High Court.

Hartogs v Sequent (Schweiz)

The first case, Hartogs v Sequent (Schweiz) AG [2019] EWHC 1915 (Ch), started with His Honour Judge Hodge QC's decision earlier this year in which the claimant, Bernardo Hartogs, sought to set aside the transfer of significant assets into two offshore trust structures on the grounds of mistake.

First transaction

In 2009, Mr Hartogs sought advice from Attendus Trust Co AG. Attendus advised Mr Hartogs that although he was resident in the UK, he was non-domiciled for inheritance tax purposes.

Accordingly, on Attendus' advice, Mr Hartogs settled funds into an offshore trust, the Milky Way Settlement Trust. This trust, in turn, acquired the second defendant, a BVI incorporated trading company, to purchase and hold a property in North West London where Mr Hartogs and his family would live. The property was purchased for £4.195m and Mr Hartogs transferred an additional £2.9m to cover the costs of renovating the property.

Second transaction

Later, in late 2013 and early 2014, Mr Hartogs sought further estate planning advice from Attendus in relation to his classic car collection.

Mr Hartogs then established a second offshore trust, the Mercurius Settlement Trust, which acquired the third defendant, another BVI incorporated trading company. Mr Hartogs transferred four of his own classic cars to the third defendant, which purchased five further cars using funds transferred by Mr Hartogs.

In 2016, Mr Hartogs instructed Linklaters, which advised him that he was, in fact, deemed domiciled in the UK for tax purposes and had been since around April 2008. This being the case, both of the aforementioned transactions gave rise to an immediate tax liability in the order of £2.9m. It was Mr Hartogs' position that this

was the first time that he had been advised of his status as a UK domiciled settlor and the resulting tax liability.

Payne v Tyler

The second case of Payne v Tyler [2019] EWHC 2347 (Ch) is an application by trustees to set aside a deed of appointment on the grounds of mistake.
Peter Mallett died on 20 November 2010 leaving half of his residuary estate to Sally Alston in his will. At the time of Mr Mallett's death, the gift to Mrs Alston was worth approximately £250,000.

Following Mr Mallett's death, Mrs Alston sought estate planning advice from Nicholas Payne, a solicitor at Womble Bond Dickinson (formerly Dickinson Dees LLP). On Mr Payne's advice, Mrs Alston executed a deed of variation (DoV) in respect of Mr Mallett's estate on 25 August 2011 pursuant to the Inheritance Tax Act 1984 s 142.

The effect of the DoV was to hold Mrs Alston's half share of the residuary estate on a discretionary trust and to remove the legacy from her own estate for inheritance tax purposes. Mr Payne, Mrs Alston and Mrs Alston's son were appointed as the trustees; and Mrs Alston, her children and remoter issue were within the class of beneficiaries of the trust so that the income of the trust would be paid to her. Shortly after the creation of the trust, Mrs Alston sought a payment from the trust to supplement her income, and the trustees made an initial payment to her of £4,000 by way of a loan. Due to Mrs Alston's income requirements, on 5 February 2012, Mr Payne proposed that the trustees make an appointment to Mrs Alston to give her an irrevocable life interest in the trust.

Mr Payne sought tax advice as to the consequences of the appointment from his colleague, Anne O'Neil, a tax specialist, on 6 February 2012. In Mr Payne's email, he stated that the trustees were considering making the appointment to 'give Mrs Alston an irrevocable life interest in the whole of the Trust Fund, but [we] do not wish to jeopardise the IHT planning that was undertaken by virtue of the DoV'.

He went on to set out his concerns: 'I think the question is whether making the appointment within two years of Mr Mallett's death carries a risk that the appointment is read back into the will, the result being an immediate post-death interest for Mrs Alston which we would want to avoid in that it would negate the IHT planning.'

On Ms O'Neil's advice that the appointment would not negate the inheritance tax planning, a deed of appointment (DoA) was executed in favour of Mrs Alston on 6 April 2012 and she became absolutely entitled to the income of the trust fund.

On 8 November 2016, Mrs Alston died. In the course of the administration of her estate and following correspondence with HMRC, it transpired that Ms O'Neil's advice was incorrect. In accordance with the Inheritance Tax Act 1984 s 144, the appointment was, in fact, an immediate post-death interest. As a consequence, the assets of the trust formed part of Mrs Alston's estate on her death and her estate was subject to additional inheritance tax in the sum of £112,000.

Pitt v Holt: the law

The Supreme Court's decision in Pitt v Holt [2013] UKSC 26 remains the leading authority on the rescission of a non-voluntary disposition for mistake. The principles derived from the judgment of Lord Walker in that case are as follows:

1. the donor must have been mistaken
– as distinguished from ignorant or inadvertent;

2. the mistake must be of a relevant type
– it must be a causative mistake; and

3. the mistake must be sufficiently serious as to render it unjust on the part of the donee to retain the property given to him.

Lord Walker held that the gravity of a mistake will be determined by reference to 'unconscionableness', 'injustice' and 'unfairness', and the above test applied equally to a mistake as to tax consequences as to any other kind of mistake. Where the test in Pitt v Holt is satisfied, the court has a discretion as to whether or not to set aside the disposition.

The High Court's decisions

In both 2019 cases, the transactions were entirely tax driven. As set out in the judgment of Judge Hodge QC in the Hartogs case, recent case law has confirmed Lord Walker's approach that if the mistake is in relation to the tax consequences of the transaction, provided it is sufficiently serious to engage the doctrine in Pitt v Holt, there is no reason why it should be treated differently from any other kind of mistake.

In *Hartogs*, Judge Hodge QC held that Mr Hartogs made the same mistake in relation to both transactions. He only became liable to pay the significant inheritance tax charges after following Attendus' advice and it was this advice which led to a mistaken belief by Mr Hartogs as to the tax consequences of the transactions.

Judge Hodge QC accepted that the transactions were not 'controversial' tax planning schemes but were, in the words of counsel for Mr Hartogs, 'vanilla tax planning'. Judge Hodge QC also accepted that Mr Hartogs would not have structured his assets in this way if he was aware of the potential charges to inheritance tax, and held that it would be unconscionable for the mistake to be left uncorrected and for Mr Hartogs to be left with a substantial and immediate tax liability.

Judge Hodge QC ordered both transfers to be set aside, concluding:

'This is a case in which the court's jurisdiction to grant relief on the grounds of mistake is plainly engaged, and in which it would be appropriate for the court to exercise its power to set both series of transactions aside.'

In *Payne v Tyler*, Master Clark also accepted that, after following legal advice, the trustees exercised their power of appointment on a mistaken basis. As Master Clark states in his judgment: 'Mr Payne was not careless: he asked the right question of the right person, and got the wrong answer… Had Ms O'Neil answered Mr Payne's question correctly, the trustees would not have entered into the DoA, or would have waited until after 20 November 2012, when the two year period after Mr Mallett's death expired.'

Master Clark considered that the mistake was sufficiently serious for two reasons. Firstly, the amount of inheritance tax payable was considerable; although it was substantially less than the liability Mr Hartogs was facing, it constituted 40% of the trust fund. Secondly, as a consequence of the mistake, the effect of the DoV, which Master Clark described as an 'unexceptionable step of tax mitigation', was negated.

Master Clark reiterated Lord Walker's approach in Pitt v Holt. Although there would be an inheritance tax saving, this was not a reason for refusing the relief sought. He concluded that it would be unconscionable to leave the mistake uncorrected and ordered the DoA to be set aside on the grounds of mistake.

Interestingly, in both cases HMRC was notified of the proceedings but did not seek to challenge the claims or to be joined as a party to either set of proceedings.

Conclusion

The recent High Court decisions serve as a welcome reminder of the principles in Pitt v Holt and their application where a party is seeking to invoke the court's equitable jurisdiction of mistake following a significant and unexpected tax liability. However, in Judge Hodge QC's judgment in Hartogs, he stresses that the doctrine should not be seen as a 'get out of jail free' card.

Furthermore, although HMRC did not, on these occasions, ask to be joined as a party to either set of proceedings, claimants should not expect that this will always be the case. They may very well find themselves facing a challenge to their claim from HMRC, particularly in cases where the steps taken to mitigate tax may be considered as 'artificial tax avoidance' and contrary to public policy.