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# CASE UPDATE - RIGHTING THE WRONG: MISTAKE AND HASTINGS-BASS IN THE ISLE OF MAN

**INTRODUCTION**

How should trustees deal with mistakes that they or their predecessors have made? This is a question of sometimes acute practical importance to trustees but the law does not always allow them the freedom of manoeuvre they once had. In particular, the English Supreme Court's decision in *Pitt v Holt, Futter v Futter* [2013] 2 AC 108 ("*Pitt and Futter*") fundamentally altered the options available to trustees of English law trusts and continues to make waves offshore.

The latest jurisdiction to produce a notable judgment dealing with the issues raised in that case is the Isle of Man. On 1 June 2016, His Honour the Deemster Doyle of the High Court of Justice of the Isle of Man made an order in *AB v CD* [CHP 16/0007] setting aside certain call options granted by a trustee and declaring them *void ab initio* such that they were deemed never to have taken effect and were to be treated by all parties as never having been granted.

In delivering his judgment on 30 June 2016, the Deemster made some important observations about the application under Manx law of the rule in *Hastings-Bass* and the Manx courts' jurisdiction to set aside a voluntary transaction on the ground of mistake. In so doing he indicated an unwillingness (common with the courts and legislature of many offshore jurisdictions) to slavishly follow English law, and, especially, *Pitt and Futter* on the topic. He also provided a useful summary of the debate as to whether decisions made by trustees without proper deliberation or by mistake are properly void or voidable, before reaching a practical conclusion on that point on the facts of the particular case.

**KEY FACTS**

The Claimant was the settlor and primary beneficiary of a number of trusts governed by Manx law. The Defendant was the trustee of the trusts.

In 2012, the trustee granted a number of call options ultimately in favour of a company beneficially owned by the Claimant and over the assets of the trusts. The call options were put in place, not for any tax motivation, but to provide the Claimant with reassurance that if the assets held in the trusts were ever in danger, there was a mechanism by which the assets could be transferred back into his beneficial ownership.

The trustee knew that the Claimant had been considering a move to the UK since 2011, and he moved there in 2012. Despite this, no UK tax advice was taken in connection with the grant of the call options and the grants were structured in such a way as to give rise to a UK capital gains tax risk for UK-resident beneficiaries. The trustee argued that it relied on relevant advisers in other jurisdictions to obtain appropriate tax advice.

It was common ground that, had the trustee appreciated the potential consequences, it would not have granted the call options. The Claimant therefore applied for an order that the call options be declared void with retrospective effect by application of the rule in *Hastings-Bass* or, alternatively, an order setting them aside on the ground of mistake.

**THE RULE IN HASTINGS-BASS**

This case represented the first opportunity for the Manx courts to consider the applicability in the Isle of Man of the rule in *Hastings-Bass* as modified in England and Wales by *Pitt and Futter*. Prior to that decision, Manx law followed the old English and Jersey law. As such, where the effect of an exercise of discretion was different from that which was intended by a trustee, the courts could interfere if it was clear that the trustee would not have acted as it did had it not failed to take into account considerations which it ought to have taken into account (inadequate deliberation), or taken into account considerations which it ought not to have taken into account (excessive execution). The rule applied irrespective of whether there had been a breach of duty by a trustee, its advisers or agents.

As a matter of English law, this changed following *Pitt and Futter*. There it was held that judicial intervention could only be justified if the inadequate deliberation was sufficiently serious so as to amount to a breach of fiduciary duty on the part of the trustee.

On the facts of this case, the Deemster held that *if* it was necessary under Manx law to establish breach of duty on the part of the trustee, such breach had been established. The Deemster examined the duties of trustees in circumstances where other advisers were involved and taking a leading role. He concluded that it was not reasonable (and a breach of duty) for the trustee to take no tax advice on its own account or to take insufficient steps to ensure that satisfactory advice had been taken, particularly where (as in this case) someone closely associated with the trustee had itself raised the issue of potential UK tax concerns.

Given that the point was somewhat theoretical in the circumstances of the case, the Deemster expressly left open the question as to whether *Pitt and Futter* on the rule in *Hastings-Bass* was good Manx law. However, he expressed serious reservations as to whether it was and envisaged strong arguments that, as a matter of principle and policy, *Pitt and Futter* should not be followed in Manx law.

**MISTAKE**

In Manx law the courts have a broad equitable jurisdiction to set aside a voluntary transaction on the ground of mistake where a trustee's decision would not have been made "*but for*" that mistake (including as to effect or fiscal consequences) (following *Clarkson v Barclays Private Bank and Trust (Isle of Man)* Ltd 2005-06 MLR 493 and *In re Betsam Trust* 2008 MLR 200). In England, the relevance and impact of the distinction between effect and consequence has been more controversial, although Lord Walker's provisional conclusion in *Pitt and Futter* that the true requirement is simply for there to be a "*causative mistake of sufficient gravity*" could be said to bring the law of mistake in England and Wales broadly in line with Manx law.

In this case, the Deemster was persuaded that the court was justified in intervening and granting relief on the ground of mistake. He concluded that it was a mistake for the trustee to fail to take professional tax advice and for it to assume that others had investigated the tax consequences. The trustee would not have granted the call options but for the mistake about the possible adverse fiscal consequences and the mistake was sufficiently serious (in that it would potentially prevent or reduce capital payments to the Claimant or his family) that it would be unconscionable to refuse relief (if unconscionability was even required).

**THE VOID OR VOIDABLE DEBATE**

There is significant debate within the legal profession as to whether decisions of trustees made without proper deliberation or by mistake are properly void (that is, automatically ineffective from the beginning) or voidable (whether they should be ineffective is ultimately a matter for election and / or the court's discretion).

In this case, the Deemster acknowledged that the law is uncertain and exemplified this (from paragraph 100 of his judgment) with a useful summary of the varying approaches taken by judges and academics in England and the offshore world. However, he took a practical approach to what should be done to deal with the situation before him: the question was not which side of the academic debate was right, but what orders the court could practically make in the circumstances. The Deemster concluded he was able to declare that the call options were void from the beginning and pointed out that in this case "*whether one uses the word void, voidable or avoided, the reality is that the [c]all [o]ptions are deemed never to have taken effect*".

In his view, in determining the appropriate relief in such cases, it is right to look at whether there is any prejudice arising to anyone from retrospective relief and / or any evidence of any material change of position of any third parties that might be affected by retrospective relief.

**CONCLUSION**

This judgment is useful on many levels. Practically, it clarifies the obligation of a trustee to seek its own tax advice even where there are other advisers involved. For those dealing with Isle of Man structures, it provides a clear indication that Manx law will not automatically follow English law, particularly where an English decision appears to be driven by UK-specific policy and tax revenue considerations. It also shows that the Manx courts will not be distracted by any uncertainty outstanding in English common law or academic debate but will instead tread their own path based on their own policy and tax revenue considerations. Finally, it may be that we see more judges in other jurisdictions taking the Deemster's practical approach and rising above the void / voidable debate in the future.

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