

Setting aside Jersey foundations: limited application of the mistake jurisdiction to foundations

B and C v D, E, F and others [2020] JRC 169

The Royal Court has recently confirmed that while a Jersey foundation cannot be set aside *ab initio* on the grounds of mistake, endowments made to the foundation can be set aside on that basis. The effect of the judgment was to reduce the tax exposure of the two founders from between £4.7 million and £6.2 million to £750,000. The decision of *B and C v D, E, F and others* [2020] JRC 169 demonstrates the Jersey Royal Court taking a sensible and pragmatic approach in applying the mistake jurisdiction to a foundation, albeit in a limited manner. It provides legal clarity for individuals seeking to set up foundations of their own to regulate their affairs and to service providers in the Jersey finance industry generally.

Foundations are a relatively new concept in common law jurisdictions, which typically make use of trusts for asset holding and succession planning. Foundations are newer still to Jersey with legislation only coming into force in 2009 to regulate their incorporation and governance. Under Jersey law, at least one member of the council, the governing body of a foundation, must be a trust company service provider based in Jersey and registered with the Jersey Financial Services Commission.

Foundations in succession planning

A foundation, unlike a trust, is a separate legal entity capable of holding assets in its own name, amongst others. Accordingly, there is a growing trend in using foundations in succession planning as a means of separating assets from an individual's personal wealth thus taking those assets out of his/her estate for inheritance tax purposes.

Background to the case

In 2009, the founders took tax advice from a UK tax consultancy in relation to estate planning for the benefit of the family's financial affairs. The Tax Report prepared by the UK tax consultancy proposed that:-

- the founders establish a Jersey foundation from which they would derive no benefit but would retain the right to demand repayment of the whole of any capital contributed by them to the foundation (the “**Founder's Rights**”);

- the founders would transfer assets to the foundation which would be owned by the foundation;
- the beneficiaries of the foundation would be the founders children, living at the time of its incorporation or born during its substance on condition that they reach 18.

The Tax Report stated that HMRC might regard the foundation as a ‘settlement’ as contemplated in section 43 of the Inheritance Tax Act, 1984. To avoid the associated Inheritance Tax liability, they advised that the founders retain the Founders Rights, which would have equal value to the assets transferred by them. The UK tax consultancy advised that in the result, the endowments to the foundation would not attract tax liability, as there would be no reduction in the founders’ estates and the assignment of the Founders Rights to the founders’ children in the future would not attract Inheritance Tax if the children survived the founders by seven years.

Acting on the advice of the UK tax consultancy the founders incorporated a Jersey foundation, transferred the Founders Rights to their children (by way of a Declaration of Trust) and thereafter made endowments to the foundation totalling £11.4 million. However, the advice of the UK tax consultancy was found to be fundamentally mistaken when the structure was reviewed in 2019. Contrary to the advice provided by the UK tax consultancy, the transfer of the Founders Rights to the beneficiaries as well as the transfer of the endowments to the foundation were not exempt from inheritance tax.

Thus, acting on the mistaken advice of the UK tax consultancy, the founders had inadvertently incurred between £4.7 million and £6.2 million in tax liability to HMRC.

Setting aside the foundation

The founders principally sought to have the foundation set aside on the grounds of mistake. An order of this nature would undo the entire structure as though it had never existed. This powerful remedy typically arises in the context of trusts. Where the Court sets aside a trust on the grounds of mistake or otherwise, the trustee holds the trust assets on the basis of a bare trust for the settlor. There is no equivalent power in the Foundations (Jersey) Law 2009. The Court held that there are significant legal and public interest reasons as to why this remedy is not available in the context of foundations namely: -

- There is a public interest in third parties being able to rely on the relevant public register for the existence of an incorporated entity and that all the requirements for incorporation have been satisfied;
- The Court already has the power to wind up a foundation on just and equitable grounds;
- By analogy, there is no equivalent power to set aside the incorporation of a company on grounds of mistake;

Importantly, if a foundation were to be set aside *ab initio* there would be no entity to transfer the assets back to the founders. Unlike a trust relationship where the trustee retains legal ownership of the assets held in trust, a foundation is both the legal and beneficial owner of the assets held by it. The remedy would therefore create a vacuum in ownership with the assets being theoretically ownerless.

Setting aside the endowments

The Court was however willing to set aside the endowments to the foundation on the grounds of mistake. It was held that although the case law in this regard predominantly concerned trusts, the law was of general application and would apply to endowments made to a foundation by its founders.

The test set out in *In the matter of the A Trust* [2009] JLR 447 and reformulated into three stages *In the matter of Lochmore Trust* [2010] JRC 068 requires the Court to ask: -

1. Was there a mistake on the part of the donor?
2. Would the donor not have entered into the transaction 'but for' the mistake;
3. Is the mistake of so serious a character as to render it unjust on the part of the donee to retain the property?

The founders' tax exposure was reduced to £750,000 in contrast to the potential liability of between £4.7 million and £6.2 million, in the result.

Concluding remarks

The case should provide some comfort to individuals exploring different means of succession planning as well as service providers in the Jersey finance industry. The foundation is a fairly new concept to Jersey and it is encouraging to note that the Royal Court is willing to exercise powerful remedies to protect individuals who find themselves operating under mistaken advice.

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