MISTAKE

Mistake: Ignorance is not bliss

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Farrer & Co

Rowan Cope is an associate in the contentious trusts and estates team at **Farrer & Co**

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In *Dukeries Healthcare Ltd v Bay Trust International Ltd* [2021], three similar claims concerning tax avoidance schemes called 'remuneration trusts' were heard together, with a fourth settled before the trial. These remuneration trusts were set up by the now infamous Baxendale Walker LLP in 2010 for a businessman called Allen Levack and the companies through which he operated his business: Dukeries Healthcare Ltd (Dukeries) and Riverside Healthcare Ltd (Riverside).

The facts of this case are not simply understood. By their very nature many tax avoidance schemes attempt to conceal the true nature of the structure and/or transactions involved so as to take advantage of loopholes in the present tax regime. Often, as in this case, it appears the client (or 'founder') to whom the scheme is sold may appreciate the intended *effect(s)* of the scheme, but rarely will a lay person understand the *precise mechanics* of how the scheme operates – and perhaps they do not want to. This is where the controversial doctrine of 'mistake' comes into its own.

The claims here were brought by Mr Levack, Dukeries and Riverside against Bay Trust International Ltd (Bay Trust), a Belize company which acted as trustee of the remuneration trusts, and A P L Management Ltd (APL), the 'personal management company' which was incorporated with Mr Levack as sole director and shareholder to serve as part of the tax avoidance structure. HMRC was also joined as a defendant, and was the only one of the three actively to defend the claims. Interestingly, the claim was brought under Part 8 of the Civil Procedure Rules rather than Part 7, as the dispute purportedly did not involve a substantial disagreement as to the facts.

The claimants relied on the doctrine of 'mistake' – as explained in *Futter v HMRCC (with Pitt v HMRCC)* [2013] – to seek relief orders to set aside the trust deeds, and their contributions to the trusts, together with orders that the assets held by Bay Trust and APL be re-vested in the claimants. Alternatively, they sought a determination that the contributions made as part of the schemes were not 'permitted contributions' (as defined in the trust deeds), and so should be re-vested in the claimants or held upon some other trusts (presumably for the claimants' benefit).

The background

The judgment describes Mr Levack as a 'successful businessman', who built and owned profitable care homes which were leased by him to Dukeries, a company of which he was a director (along with his wife and daughter, and one other) and sole indirect owner. Mr Levack also owned a hotel which he leased to a subsidiary of Dukeries, and developed and owned 50% of a secure hospital which was leased to Riverside, a company of which he was also a director, and held a substantial stake. His wife was an employee of Dukeries, and his daughter was an employee of Riverside, as well as being a former employee of Dukeries, which is worth bearing in mind for when we consider the mechanics of the remuneration trust schemes. Mr Levack, Dukeries and Riverside all received tax advice from David Fell.

Mr Levack was first introduced to Baxendale Walker LLP in early 2010, when Mr Levack and Mr Rhoden (two of the three directors of Riverside) were considering how to mitigate their CGT liability on a potential sale of the hospital leased to Riverside. After initially communicating with Mr Fell, Paul Baxendale-Walker attended a meeting with Mr Fell, Mr Levack and Mr Rhoden in February 2010. At this meeting, Mr Baxendale-Walker steered the conversation away from CGT to the profitability of Dukeries and Riverside, and suggested that each of the companies as well as Mr Levack set up a remuneration trust via an ‘Onshore Wealth Administration Arrangement’.

Mr Baxendale-Walker explained ‘very quickly and with great confidence’ (at para 107) that offshore discretionary trusts would be set up for each of Mr Levack, Riverside and Dukeries (the founders), ostensibly for the benefit of people and businesses who provided services to the companies, as well as for future – but crucially not present or past – employees. He said the money would never in fact reach the offshore trustee (Bay Trust), but would instead be paid to a ‘personal management company’ (the second defendant, APL, of which Mr Levack was sole director and shareholder), which could in turn make loans to Mr Levack. The fees for the scheme (which were substantial) would be paid to a Channel Islands company called Minerva. The judgment describes the schemes sold by Mr Baxendale-Walker as ‘on any view out of the ordinary’ (at para 17).

The remuneration trusts were established quickly in order that the claimants could take advantage of them before the end of the tax year on 31 March 2010. The steps followed by Mr Levack, Dukeries and Riverside were broadly similar, under the guidance of advisers working with or for Baxendale Walker LLP. In the years to 2016, the claimants paid contributions of many tens of millions of pounds into the remuneration trusts.

Remuneration trust

For readers who are not familiar with such schemes, a remuneration trust is established ostensibly to remunerate individuals who provide services to the ‘founder’ of the trust (a sole trader, partner in a partnership, or company). However, in reality the contributions made to the trust are almost always intended to be accessed not by this class of beneficiaries but by the founder personally through unsecured loans or fiduciary receipts. The aim of this contrived arrangement is to minimise the amount of tax paid on money flowing in and out of the trust by taking advantage of certain tax loopholes. Remuneration trusts were a mainstay of Baxendale Walker’s practice around the period when Mr Levack commissioned the scheme for himself and his companies, and are now widely recognised to be tax avoidance structures, as identified in HMRC’s ‘Spotlight 51’ guidance dated 10 May 2019.

The remuneration trusts Mr Baxendale-Walker sold to Mr Levack appear essentially to be a succession planning tool. They sought to reduce liability for taxes including corporation tax, tax on earnings, and inheritance tax, by attempting to prevent the remuneration trusts being construed as employee benefit schemes (which are more aggressively taxed), while permitting unsecured loans to be made to Mr Levack during his lifetime, with interest in arrears to be deducted from his estate, after which point his family would be able to benefit from the trust funds tax-free.

The problem with this sort of scheme is that, at the time they are sold, they are often untested. Mr Baxendale-Walker tried to reassure his clients by citing case law, including *Dextra Accessories Ltd v MacDonald (HMIT)* [2003], and explaining that HMRC accepted and in any event was bound by these rulings. It was only when HMRC brought a claim against Mr Levack in the First-tier Tribunal (Tax Chamber) for unpaid taxes that the efficacy of the scheme was put under the spotlight. At the time the *Dukeries* case was heard, this claim had been stayed, but there seemed to be general acceptance among the parties that HMRC was likely to succeed in its case against Mr Levack and the companies.

Key documents

The court prioritised documentary over witness evidence, perhaps even more so than usual given the nature of the case, and in particular relied on three sets of documents:

The remuneration trust deeds

The trusts were intended to be discretionary in nature, with a wide class of 'beneficiaries' who comprised suppliers of services to the claimants. The trustees were given the usual suite of powers, although their power to make loans was particularly wide, and the protector (Mr Levack) had the power to amend the trust deeds, with trustee consent, which he exercised in 2012.

Each of the three deeds sought to limit the definition of beneficiaries by imposing three provisos, primarily to ensure the trust was not classified as an employee benefit scheme:

- preventing a class of 'excluded people' (including the founder, people connected with the founder, and 'present or former' employees – see *Dukeries* at para 52(i)) from benefiting;
- restricting the power of the trustees to preclude them from benefiting these excluded people; and
- preventing the trust fund from being accounted for as an asset of the founder.

You will note that these restrictions are unusual and difficult to evaluate.

For similar reasons, the definition of 'permitted contribution' was restrictively defined as follows at para 52(v):

> *… in respect of any contribution from the Founder to the trusts hereof, means a payment by the Founder which does not constitute an 'Employee Benefit Contribution' (as that phrase is defined in Section 143 and Schedule 24 FA 2003 and Section 245 FA 2004) nor a sum which falls within the provisions of Section 43 FA 1989.*

Board resolutions

Between late February and early March 2010, Dukeries and Riverside held meetings to authorise Mr Levack to instruct Baxendale Walker, and to approve fees of £15,000 plus VAT and 10% of any contributions made into the remuneration trusts (via the company called Minerva). In late March, Baxendale Walker provided pro-forma minutes to both companies and to Mr Levack, which gave approval to the trusts being set up, the trust deeds being executed and the contributions for that financial year being made. These were signed without amendment.

Guidance and marketing material

Mr Levack describes being inundated with paper, including an Onshore Wealth Administration Memorandum 2009 Update, a Remuneration Trust Summary, FAQs, and later, a Report to the Board (addressed to the directors of Dukeries) and a Manual (addressed to Mr Levack), which purported to explain in detail the mechanics of the remuneration trusts. He explained during cross-examination that he had skimmed some of these, but did not fully understand their contents.

The judgment

Deputy Master Marsh, who heard the case, decided it was logical first to consider whether Bay Trust, the offshore trustee, was entitled to receive the contributions, and second, whether the trusts should be set aside on the grounds of mistake.

Construction of the deeds

The claimants put forward at para 99 that 'the entire purpose of the Remuneration Trusts was to minimise tax, while providing for Mr Levack and his family'. In reality, they achieved the opposite effect, removing Mr Levack and his family from benefiting, and – if HMRC's claim is correct – substantially increasing the tax liability on the contributions into and payments out of the trusts.

Dukeries and Riverside (the position for Mr Levack, as a sole trader, was slightly different) contended at para 76 that, as trusts authorised payments to employees of the founders and as a result were employee benefit schemes, contributions made to the trusts were void, because these were not 'permitted contributions'.

Deputy Master Marsh clarified that the correct approach to construing the trust deeds was to bear in mind their overarching purpose as discretionary trusts for the stated class of beneficiaries. He rejected the construction placed upon the deeds by the claimants, and explained at para 82 that, properly construed, they permitted the trustee to receive contributions that did not contradict the terms of the trust, and could not be reversed simply because they did not fit with the founder's intentions.

Mistake

The claimants said at para 98 they were mistaken about the four matters:

> *i) That Mr Levack could benefit through commercial loans through his lifetime.*
>
> *ii) That his family could benefit after his death.*
>
> *iii) On the assumption HMRC's case in the First-Tier Tribunal [was] correct, that the trusts would not trigger income and NIC tax charges as being earnings for Mr Levack.*
>
> *iv) That contributions would not be transfers of value for IHT purposes and the associated mistake that the trusts satisfied section 86 IHTA 1984.*

In his judgment, Deputy Master Marsh quotes extensively from *Futter*. While it is not appropriate or necessary to reproduce these excerpts here, Lord Walker's seminal judgment does of course have considerable bearing on the analysis in this case. Deputy Master Marsh used the summary of the relevant factors as set out in *Van der Merwe v Goldman* [2016]. This condenses Lord Walker's analysis into a list of ten key factors (para 83), which act as a convenient starting point from which to consider mistake. From this list, Deputy Master Marsh concluded that three points were material:

Is there sufficient evidence of a causative mistake of sufficient gravity having been made?

Deputy Master Marsh explained at para 131 that the gravity of the mistake should be assessed by examining the facts closely (whether or not they are tested by cross-examination), including the circumstances of the mistake and its consequences for the person who made the erroneous contributions. The relevant time was when the operative mistake was said to have happened, ie when the trust deeds were executed by Mr Levack and the companies, by their directors.

He focused in particular on the quality of the evidence provided, and was unimpressed by the following:

- The use of Mr Levack's witness statement to set out extensive sections of the Manual and the Report to the Board, as well as the trust deeds themselves, drawing attention to particular elements of the schemes and explaining their function, in spite of his later admission during cross-examination that he either had not read or did not understand these documents (at paras 108-122, 130).
- The failure to hear from other individuals whose evidence could have had a bearing on the outcome, for example Mr Levack's wife and daughter, and other directors of the companies.
- The lack of detail in the account of Mr Fell, the tax adviser to the claimants. Mr Levack's evidence rested in part on the fact that Mr Fell had a more sophisticated understanding of the nature of the loans than he did. The judge held at para 128 that Mr Fell's evidence:

  > *… not only does not materially assist the claimants' case, his silence on topics that are crucial to the claimants' cases is positively unhelpful to the claimants' case.*

Deputy Master Marsh concluded at para 133 that he could place:

> *… little if any reliance upon Mr Levack's evidence about his understanding of [the] way the schemes would affect his and the companies' liability to tax and his ability to pass wealth to his family.*

As a result, he held that the claims failed due to the inadequate evidence that had been provided about the claimants having acted under a mistake of so serious a character to render it unjust on the part of the first claimant to retain the gift (para 135).

If there was such a mistake, did Mr Levack run the risk of being wrong or must be taken to have run that risk?

Having determined that there was insufficient evidence, Deputy Master Marsh continued, obiter, to examine whether Mr Levack was willing to run the risk of being wrong. He considered that, in spite of his incomplete understanding, Mr Levack 'accepted the scheme, warts and all' (para 137). This was because Mr Levack failed to take independent advice, there was no evidence of due diligence, and he did not properly review the available documents before depositing millions into the schemes. Tellingly, he said he decided to proceed immediately after leaving the initial meeting with Baxendale-Walker. As a result, he 'deliberately ran the risk' of the schemes not proceeding as hoped or expected from the sales pitch.

If not, is the mistake or mistakes such that it would be unconscionable for the remuneration trusts to remain in place?

As a final blow, Deputy Master Marsh determined that the schemes were properly characterised as being artificial tax avoidance. He said at para 140 that, even if there was no actual assumption of risk, it was reasonable in this case to conclude that Mr Levack, Dukeries and Riverside must be taken to have accepted the risks of the schemes failing. As a result, the claimants had not shown that it would be unconscionable for them to remain bound by the schemes.

Lessons for practitioners

The judgment serves as a reminder of a number of key issues, some of which are specific to mistake claims, and some which have wider application:

- Clearly establishing an accurate and complete picture of the factual background in a mistake claim is exceptionally important. This is because, as per Lord Walker at para 126 in *Futter*, '[t]he court needs to focus intensely on the facts of the particular case', and also because (at para 127 of *Futter*):

  > *… the court may have to make findings as to the state of mind, at some time in the past, of a claimant with a lively personal interest in establishing that there was a serious causative mistake.*

Ensure that you call all relevant witnesses, and in particular a client's tax advisers.

- The point at which you need to establish the nature of the claimant's knowledge is when the relevant document is executed (para 124 of *Futter)* so, in this case, the execution of the trust deeds which settled the remuneration trusts. The claimant's understanding before and after this point is only relevant to the extent it speaks to their knowledge at the time, and objective contemporaneous evidence will almost always be preferred to a witness's subjective memories.
- A key element of the test for mistake is whether the claimant accepted the risk that the scheme may not work, as examined obiter in this case. In this context, the court will certainly bear in mind whether the claimant conducted sufficient due diligence, took the time to read the documentation that they were provided with in detail, and received independent advice, even if their appreciation of the position having taken these steps was still flawed.
- That the primary purpose of the document in relation to which mistake is claimed is tax avoidance is not fatal to a claim, but does in general appear to have a substantial bearing on how strictly the judge interprets the test as set out in *Futter*. As ever, they will be led by the law, but will also be inclined to follow their conscience.
- As tempting as it may be to use your client's witness statement as a vehicle by which to draw attention to relevant sections of documents in evidence in the proceedings, this is very likely to backfire if your client has an unsophisticated or incomplete understanding of these documents, and will rightly be seen by the court as an attempt to misrepresent their appreciation of the evidence. This point is especially pertinent in mistake proceedings, where the entire claim is underpinned by the claimant's actual knowledge at the time the relevant documents were executed.
- It may seem trite, but the knowledge of a company is the 'collective intention' of its board of directors (para 97 of *Futter*), a fact which often seems to be forgotten in family companies where a patriarch, for example, has particular influence on the administration and strategic direction of the companies they have established in the course of their business. In this claim, it was not sufficient for the court to appreciate the understanding of Mr Levack alone at the time the relevant minutes were executed or deeds signed. It was also necessary to hear evidence of the state of mind of the other directors (which was not, in this case, provided).
- Extending this thought, pro-forma minutes and similar 'off the shelf' documents may often be convenient and cost-effective, but when implementing unusual or complex decisions, it is always better to use tailor-made documents which demonstrate the real understanding of the parties involved. A court is highly unlikely to consider that template board minutes, for example, reflected the actual intentions and understanding of the company at the time.
- *Futter* remains the touchstone for mistake cases, and the facts should always be assessed with close reference to Lord Walker's findings in that case.

Cases Referenced

- Dextra Accessories Ltd & ors v Macdonald (Inspector of Taxes) [2002] UKSPC SPC00331; [2003] WTLR 349 SpC
- Dukeries Healthcare Ltd v Bay Trust International Ltd & ors [2021] EWHC 2086 (Ch); [2021] WTLR 809 ChD
- Futter & anr v HMRCC (with Pitt v HMRCC) [2013] UKSC 26; [2013] WTLR 977 SC
- Van der Merwe v Goldman & anr [2016] EWHC 790 (Ch); [2016] WTLR 913 ChD

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