Neutral Citation Number: [2019] EWHC 2416 (Ch)

Case No: PT-2018-000977

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS
PROPERTY, TRUSTS AND PROBATE LIST

Rolls Building,
Fetter Lane,
London.

Date: 10 September 2019

Before :

MASTER SHUMAN

- -

Between :

(1) ABC	**Claimants**
(2) DEF	
(3) GHI	
- and -	
JKL	**Defendant**

- -
- -

Francis Barlow QC and Matthew Smith (instructed by **Michelmores LLP**) for the **Claimants**
Alexander Drapkin (instructed by **Adams and Remers LLP**) for the **Defendant**

Hearing dates: 2 May 2019

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MASTER SHUMAN

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1. The claimants bring a claim by Part 8 claim form seeking rectification or in the alternative rescission of a deed of appointment dated in 2010 ("the 2010 deed"). The claim is supported by a witness statement from the first claimant.

2. The claimants are the current trustees of a number of trusts relating to an estate in England ("the estate"). The claim concerns a particular fund that was created by a deed of appointment dated in 1978 ("the T fund"). The defendant is the beneficiary of the relevant sub-fund of the T fund and does not oppose the claim.

3. HMRC have been notified of the claim but do not wish to be made a party. They have asked that certain authorities were referred to me, which they were in some detail.

4. I made an order for rectification of the 2010 deed at the disposal hearing. I indicated that I would send out my reasons at a later date. I am very grateful for the skeleton argument and submissions made by Mr Barlow QC and Mr Smith on behalf of the claimants, in respect of both rectification and rescission. In the circumstances it was unnecessary for me to consider the rescission claim.

THE LAW

5. The law for current purposes is helpfully set out at paragraphs 4-058 to 4-087 of Lewin on Trusts (19th Ed, 2015). In relation to rectification of a voluntary settlement on the ground of mistake, paragraph 4-069 summarises the 4 necessary conditions as follows:

> "(1) There must be convincing proof to counteract the evidence of a different intention represented by the document itself;
>
> (2) There must be a flaw (that is an operative mistake) in the written document such that it does not give effect to the settlor's intention;
>
> (3) The specific intention of the settlor must be shown; it is not sufficient to show that the settlor did not intend what was recorded; it must also be shown what he did intend; and
>
> (4) There must be an issue capable of being contested between the parties affected by the mistake notwithstanding that all relevant parties consent."

A similar test applies to the trustees.

6. The burden is on the claimant to demonstrate the specific intentions of the trustees which, owing to a mistake made in the recording of those intentions and in the drafting of the instrument, were not recorded in or were mis-recorded in the instrument. So long as the evidence shows, with some degree of precision, what the trustees intended it is not necessary for the trustees to have specified the precise form of wording.

7. The law was that a general intention to achieve a fiscal objective, without more, was not sufficient. Although as a general proposition I am not convinced that has survived Pitt v Holt [2013] UKSC 26. The true focus, as Lewin accurately describes, "is on whether the evidence proves an intention to include specific words or to achieve a specific intention which is not achieved by reason of a mistake in drafting[1]." The fact that rectification furthers some fiscal objective does not bar the claimant from the relief sought.

8. The court must be persuaded that the effect of leaving the mistake unrectified is unjust but should make the minimum changes possible in order to correct the mistake.

THE BACKGROUND

9. In the 1930s the settlor ("the settlor") settled certain property on trustees in contemplation of the marriage of her son ("the settlement"), creating a royal lives strict settlement. Clause 3 gave very wide powers of appointment with a default trust in tail for male heirs of her son in clause 4. The settlor's son had a son with his wife. That son went on to have 4 children with his wife; the defendant is the youngest of those children. The defendant's siblings married. The defendant and his long-term partner are unmarried and have three children, all of whom are minors.

10. The settlement declared discretionary trusts for the benefit of the issue of an ancestor of the settlor's late husband, with the exception of one branch of the family, and their respective wives, husbands, widows and widowers.

11. By deed of appointment made in 1978 ("the 1978 deed") certain land and other hereditaments comprised in the estate were settled on trust for a descendant of the ancestor for life with remainder on trust for such of the children of her brother as should attain the age of 40 or be living and under that age on a defined appointed day in equal shares but sons taking double the share of daughters, the T fund. There was also a substitutional proviso and the statutory power of advancement was expressly incorporated without restriction to one half of the vested or presumptive share of a beneficiary. The relevant descendant died childless in 1988 so that the default trusts took effect and the children of her brother took the T fund. The defendant is one of those children.

12. The settlement contains no provisions modifying the construction of references to issue. Clause 5 of the 1978 deed provides that it should be construed as if section 15 of the Family Law Reform Act 1969 and the Children Act 1975 had not been enacted. The effect of that is that illegitimate, legitimated and adopted children are excluded from benefiting. Members of the beneficial class comprise only issue who are legitimate and claim descent from the ancestor exclusively through persons who are themselves legitimate.

13. The T fund was amended by a deed of advancement dated 19 November 1991 ("the 1991 deed"). Under the 1991 deed the defendant's share of the T Fund was irrevocably resettled on trusts for his benefit as set out in the schedule to the 1991 deed, as were two of his siblings' respective shares in the T Fund: effectively creating 3 sub-funds. By paragraphs 1(1) and 3 of the schedule the trustees were directed to

[1] Paragraph 4-072.

hold the defendant's share on trust to pay the income to him until he attained the age of 39. The trustees were given power at any time before the defendant attained 39 years to pay or apply the whole or any part of his share to him or for his benefit. The trustees were directed to hold the share on trust for the defendant absolutely if he attained 39 years. The defendant's sub-fund of the T Fund is known as the TT fund, it comprises a number of properties and had a value in 2010 of several millions of pounds.

THE 2010 DEED AND THE CLAIM

14. Between approximately 1993 and April 2013 A LLP, solicitors, acted for the trustees. The main contact was a partner, R, who was assisted from time to time by another solicitor, Miss C. R died in 2009.

15. At a trustees' meeting held in late 2009 the trustees agreed that the defendant's life interest should be extended to avoid him becoming absolutely entitled to the capital of his share of the T fund. The defendant's birthday was early in the following year. The trustees had taken similar steps when the defendant's siblings had each approached their 39th birthday to avoid a significant capital gains tax liability.

16. The Chief Executive of the estate instructed Miss C to prepare the necessary documentation. It was a well-known fact that the defendant was not married to his partner and therefore their 3 children were illegitimate for the purposes of the trust. Approximately 6 weeks later Miss C sent the 2010 deed to the second claimant for execution and forwarding on to the other trustees. This deed was apparently lost and 4 weeks later Miss C sent a further copy of the 2010 deed for signature. By this stage the defendant's birthday was fast approaching.

17. The first claimant refers in his witness statement to a telephone conversation that he had with Miss C a few days before the defendant's birthday. There may be an issue between the first claimant and Miss C as to the extent of that conversation. A LLP are not a party to the proceedings and it is unnecessary and would be inappropriate for me to make findings about what was said or not said during that telephone conversation.

18. The first claimant's evidence, which I accept, is that the trustees executed the 2010 Deed in the belief that:

    (1) It simply extended the defendant's life interest;

    (2) It would enable the trustees to continue to apply capital for the defendant's benefit and the first claimant understood that would also permit applications to the defendant's children and indeed his partner notwithstanding that he was not married to his partner;

    (3) It would not trigger any charge to inheritance tax.

19. In 2013 the claimants' solicitors were instructed by the trustees in place of A LLP. During a review in or about 2015 the trustees were made aware of issues with the 2010 deed. Thereafter there was correspondence with HMRC as to the tax consequences of the 2010 deed.

20. The 2010 deed was drafted in such a way that its effect was very different to what the trustees thought was being achieved. I have had the benefit of a detailed exposition from Mr Barlow QC on the defects in the drafting of the 2010 deed and the consequences of the 2010 deed.

21. I find that the 2010 deed has the following consequences:

(1) The new restricted power under clause 3(b) prevents the trustees from benefiting the defendant's partner and their children.

(a) The trustees power to advance capital for the defendant's benefit was drafted in an unusual way. The power in the 1991 deed was drafted widely in a standard way. It authorised the application of capital for the defendant's benefit by resettling it on trust for the benefit of the defendant's partner and their children, even though they were not beneficiaries under the trusts declared by the 1991 deed.

(b) Whilst the reference to the defendant's children in clause 3(a) was unqualified, in light of the settlement and the express terms of the 1978 deed it did not include his children because they are illegitimate. Unless the defendant and his partner married the reference to "wife" in clause 3(c) could not be construed to include the defendant's partner.

(c) In contrast to the position under the 1978 deed the power under clause 3(b) of the 2010 deed to "pay or transfer all or any part or parts of the capital" to the defendant "for his own absolute benefit" does not authorise the trustees to settle capital for his benefit and therefore they cannot settle it on trusts for the defendant's partner and their children.

(2) The defendant's qualifying interest in possession in his share of the T fund under the 1991 deed has been terminated. This triggers immediate and future inheritance tax ("IHT") liabilities.

(a) A new interest in possession has been conferred on the defendant which does not qualify as a transitional serial interest and exposes his share of the T fund to an IHT charge of 20% under the Inheritance Tax Act 1984 ("IHTA 1984").

(b) As the defendant's life interest under the 2010 deed is not a qualifying interest in possession within the meaning of the IHTA 1984 the defendant's share in the T fund became "relevant property" for IHT purposes exposing it to the decennial IHT charge under section 64. The first occurred on the 80th anniversary of the settlement and it is likely that there will be further periodic charges.

(c) As the defendant has become entitled to a new non-qualifying interest in possession in the T fund he will be treated as having reserved a benefit under the Finance Act 1986, section 102ZA. On his death and subject to potential relief the fund will suffer a further 40% IHT charge.

(d) As the defendant's life interest is not a qualifying interest in possession there will be no tax-free revaluation for CGT purposes of the assets comprised in the defendant's fund on his death.

22. It is difficult to see how much further the effect of the 2010 deed could have been from the intentions of the trustees. Not only did it now restrict the trustees power of advancement so that they were unable to benefit the defendant's children and his partner, as they had been able to do under the 1991 deed, it triggered immediate and future significant tax consequences.

23. I am satisfied on the evidence before me that the intention of the trustees in late 2009 and early 2010 was simply to extend the life interest of the defendant. Indeed the evidence of how they treated the other siblings' respective life interests, the decision of the trustees at the meeting on the 22 October 2019, the instruction to A LLP and the first claimant's evidence provide compelling evidence as to their intention.

24. I have already set out above what the legal effect of the 2010 deed was and there were unquestionable flaws in the way in which it was drawn so that it did not give effect to the claimants' intentions.

25. Mr Barlow QC submitted that as a matter of law it would have been possible to extend the defendant's life interest without determining it. I was referred to Holmden v IRC [1968] AC 685 in which the House of Lords held that an arrangement under the Variation of Trusts Act 1958 extending a discretionary income trust limited to cease on the settlor's widow's death did not operate to determine that interest but operated to enlarge, extend or prolong it so it did not give rise to an estate duty charge under the Finance Act 1940, section 43. In DC v AC [2016] EWHC 477, a case that Mr Barlow QC appeared in, the Chancellor approved an arrangement varying the trusts of a fund held on trust for a beneficiary for life with an absolute entitlement to capital in 2047 by deferring that entitlement. He did not consider that it gave rise to a termination of the beneficiary's interest in possession. At paragraph 19 he said,

> "I am also satisfied that the proposed arrangement in relation to ECTS would not determine the subsisting interest in possession. Under the existing trusts DC's interest in possession, being the present right to the present enjoyment of the income of the trust property, lasts for the life of DC both up to and beyond 3 April 2047. The proposed arrangement defers his right to capital to 2141 (when he is unlikely to be alive) but not to income, which he will continue to receive, subject to any revocation and reappointment by the trustees, for the rest of his life under the existing trusts. The proposed arrangement does not therefore involve termination of DC's present interest in possession. Although the point does not strictly arise, if the existing interest in possession had been extended by the proposed arrangement, then there would again be no termination of the interest in possession. The arrangement would enlarge, extend or prolong it: see *Holmden* … ."

26. The effect of the 2010 deed was to terminate the defendant's life interest and create a new life interest. I am satisfied that it could have been drawn to achieve the trustees' intentions.

27. Further the 2010 deed removed the power of the trustees to apply capital for the defendant's benefit and settle it on trusts for the defendant's partner and children. A

power that they had previously had and which, I am satisfied, they did not intend to have removed. Indeed all they wished to achieve was to prolong the defendant's life interest. It is clear that Miss C or whoever drafted the 2010 deed did not appreciate the flaws in the drafting. In a memorandum prepared by A LLP at the time of drafting, only part of which may have been read to or referred to the first claimant, it is stated,

> "Since the trustees have a power to apply capital for [the defendant's] benefit before his 39th birthday the deed prepared is designed to operate so that the trustees leave [the defendant's] right to income untouched but they postpone all of his entitlement to capital.
>
> I take the view that [the defendant's] right to capital arose when he first became entitled to income (prior to [2006]) and the deed will neither terminate nor replace such."

It is clear that the drafter failed to understand the effect of the draft 2010 deed.

28. I have also considered whether the position of the defendant's children might be resolved by construing the 2010 deed in a particular way. In light of the express terms of the 1978 deed I am not satisfied that one could read the word "children" in the 2010 deed as referring to the defendant's three illegitimate children. In any event the fact that construction is theoretically possible, I put it no higher than that, does not preclude rectification. Further construction alone will not cure the other flaws in the 2010 deed.

29. There was a delay between the execution of the 2010 deed and the issue of this claim. However that was understandable in the circumstances. I am satisfied that the true position did not emerge until the claimants instructed new legal advisers. They in turn had to consider the effect of the 2010 deed and enter into correspondence with HMRC. Save for HMRC, who would obtain an unintended windfall if the mistake was not corrected, no third parties will be adversely affected by an order for rectification. Quite properly the claimants' solicitors have invited HMRC to be joined as a party to the proceedings, who declined that invitation. I am also satisfied that there are contestable issues in this case in respect of the restriction in the trustees' power. In theory this might cause an issue between legitimate and illegitimate children and between spouse(s) and the defendant's partner.

30. In conclusion I am satisfied that all of the conditions are amply met for rectification of the 2010 deed. It is appropriate for me to order rectification in the terms sought as that is the minimum necessary to correct the flaws in the 2010 deed.