EDWARD WOLFF (1) BRIDGETTE EVELYN WOLFF (2) v NICOLA JOCELYNE WOLFF & 5 OTHERS[1]

Karen Hepworth[2]

Mann J set aside a reversionary lease (forming part of an inheritance tax saving scheme) on that ground that the claimant taxpayers made a serious mistake as to its legal effect

Background

Readers will be familiar with *Gibbon v Mitchell & Ors*[3] in which Millett J (as he was then) set aside a deed of surrender of a protected life interest on the basis that it had an effect not intended by the maker. In that case, the Claimant (Mr Gibbon) sought to surrender his protected life interest over which there was with a limited power of appointment in favour of a surviving spouse, thereafter to his children. Mr Gibbon's intention was that his 2 adult children would take immediate beneficial interests in the capital and income of the trust fund. However, he had not appreciated that his life interest was protected and upon his purported surrender the default discretionary trusts under section 33 of the Trustee Act 1925 (in favour of a wider class of objects than his 2 adult children) became operative, contrary to his intention.

1 [2004] EWHC 2110 (Ch), [2004] STC 1633; [2004] WTLR 1349.

2 Barrister, 5 Stone Buildings

3 [1990] 1 WLR 1034. See also *Hood of Avalon (Lady) v Mackinnon* [1909] 1 Ch 476.

After reviewing the case history Millett J came to the conclusion that a transaction

> *"will be set aside for mistake whether the mistake is a mistake of law or of fact, so long as the mistake is as to the effect of the transaction itself and not merely as to its consequence or the advantages to be gained by entering into it"*[4].

To the extent that Mr Gibbon anticipated the consequences of the transaction Millett J held that,

> "*It is true that if he* [Mr Gibbon] *were asked the narrow question whether he intended to release his protected life interest or the power of appointment in favour of his children, he must have answered "Yes", for he was expressly advised by his solicitors that both those steps were necessary in order to achieve his object. But he did not intend to surrender his protected life interest or to release the power of appointment save for the purpose and with the effect that the beneficial interest in the capital of the fund should forthwith vest indefeasibly in [his 2 children]. He did not have the intention of releasing his protected life interest or the power of appointment in vacuo or for its own sake, but solely to achieve the purpose I have stated*[5]*'*.

The deed was set aside.

The Facts

The Claimants, Mr and Mrs Wolff, had heard of an inheritance tax saving scheme which a friend had entered into. They saw a copy of their friend's scheme documents and thought that it would involve giving their 2 daughters the family home (of which Mr and Mrs Wolff were freehold owners) whilst continuing to live in it. Subsequently, Mr and Mrs Wolff made an appointment to see their friend's solicitor, Mr K, to discuss entering into a similar scheme themselves.

Mr K agreed to prepare scheme documents for Mr and Mrs Wolff and an appointment was made to "talk about the details of the scheme". That was in January 1997; by trial in 2004 Mr and Mrs Wolff had a limited recollection of what was discussed with Mr K. It appears that both Mr and Mrs Wolff

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4 *Ibid.* p.1309

5 *Ibid*

understood that they would grant a lease of the family home to their daughters, and Mr Wolff appreciated that the lease would not come into operation for 20 years. However, crucially, neither claimant knew that when the lease came into effect they would have no right to occupy the family home.

Mr K prepared:

(1) a reversionary lease of the family home in favour of the Wolffs' 2 daughters, commencing June 2017 for a term of 125 years at an annual peppercorn rent (if demanded); and

(2) a trust deed which Mann J describes in his judgment as 'manifestly defective'[6].

The trust deed (between the Wolffs as settlors, the Wolffs and a third party as trustees and 2 mortgagees of the family home) purported to settle the lease on trust, providing *inter alia*, the Wolffs' daughters with a life interest in the income generated by the trust property. Mann J was satisfied that these drafts evidenced (along with other factors) Mr K's lack of understanding of the scheme insofar as he failed to understand that Mr and Mrs Wolff had no interest in the lease that would allow them to settle it on the terms provided.

In 2001 the Wolffs were informed (by a different solicitor whom they had instructed to prepare their wills) that from June 2017 they had no right to live in the family home. They had not appreciated this, or that there would a tax charge under the reservation of benefit rules[7] if they continued to live in the property after May 2017. They had never intended to pay a full market rent for the family home in order to avoid a charge under the reservation of benefit rules. On the contrary, it was their intention to live in the family home for as long as they wished, paying (at most) a peppercorn rent. The Wolffs subsequently brought a claim to set aside the reversionary lease on the ground that they executed it under a mistake as to its legal effect.

The Decision

After noting that it was unclear to him what level of understanding Mr and Mrs Wolff actually had of the scheme in 1997, Mann J made 2 central findings of

6 *Ibid,* paragraph 9.

7 s102 Finance Act 1986.

fact:

(1) The Wolffs did not know that the effect of the lease was to deprive them of their right to occupy the family home post May 2017; and

(2) The Wolffs intended their daughters to have access to capital.

Based on (1) Mann J was satisfied that the lease should be set aside on the ground of mistake. He also indicated that if necessary he would have set aside the settlement.

On the facts, it was held that Mr and Mrs Wolff had not intended the scheme to have its actual effect. They understood that they were granting a lease of the family home, and that the consequence of their actions would be that there was a lease of the property, but they did not realise that the effect of their actions would be to remove their security of tenure.

Effects and consequences are not always easily distinguished. In *AMP (UK) plc v Barker*[8] Lawrence Collins J discussed Millett J's[9] distinction between consequences and effects, which he explains[10],

> '*is simply a formula designed to ensure that the policy involved in equitable relief is effectuated to keep it within reasonable bounds and to ensure that it is not used simply when parties are mistaken about the commercial effects of their transactions or have second thoughts about them'*.

A year earlier, in *Dent v Dent*[11] David Young QC, sitting as a deputy high court judge, commented that

> '*by "effect" I understand Millett J to mean the purpose or object of the transaction. To determine the purpose or object it is necessary to look at the intention of the settlor or disponer*[12]*'*.

8 [2001] PLR 77

9 In *Gibbon v Mitchell* (above)

10 At paragraph 70

11 [1991] 1 WLR 683

12 *Ibid*, p.693

Thus, if the Wolffs' intention was to save inheritance tax whilst also living in the family home for the rest of their lives should they wish to do so, then they would fall on the right side of the distinction between effect and consequences - on Mann J's findings of fact the Wolffs never intended to extinguish their right to live in the family home or confine their daughters' interests to income only.

Conclusion

The decision in this case highlights the dangers of selling 'off-the-shelf' tax saving schemes, both for the legal adviser who has not come to grips with the full nature and implications of the scheme (and the possible claim in professional negligence that may be made against him if his client subsequently suffers a loss) and for the client who is left with a scheme, the effect of which they do not fully appreciate and which may prove difficult (if not impossible) and/or costly to unpick.

There may be individuals who have entered into tax saving schemes and who now face income tax charges under the pre-owned assets legislation, but who did not fully appreciate the effect of the scheme at the time of entering into it. In most cases the client will not be able to apply to set aside the scheme which they have entered into on the grounds of mistake, but it is worth exploring the facts of each case carefully in order to consider all of the available options.