Private Client eBriefing

Taking risks and tax avoidance – Bhaur v Equity First Trustees (Nevis) Ltd [2023] EWCA Civ 534

Article by Lemuel Lucan-Wilson, 28th July 2023

The recent case of *Bhaur v Equity First Trustees (Nevis) Ltd* [2023] EWCA Civ 534 provides a timely reminder of the difficulties and risks in seeking to use the equitable mistake doctrine to avoid the intended effects of a tax avoidance scheme.

In *Bhaur*, the tax avoidance scheme was an employee benefit trust. Mr and Mrs Bhaur had a substantial property business which was transferred to a UK company (Safe Investments UK) as part of the scheme. Safe Investments UK then transferred the property business to a BVI trust company, to be held for the benefit of the employees of Safe Investments UK, or any spouse, child or dependent of such, although any persons who were "*participators*" or connected with them could not benefit (this would, at the time, have included Mr and Mrs Bhaur) other than receipt of income.

The scheme sought to take advantage of a perceived loophole, that those connected to participators could benefit after the death of that participator, so the Bhaur children would then avoid the need to pay inheritance tax. The assets were then transferred several further times, albeit it not to any material effect for the claim in mistake. Ultimately, after challenge by HMRC, the trustee then took steps to collapse the trust entirely, and appointed the income out to Mr and Mrs Bhuar and their children, and then appointed the capital out to the NSPCC; no doubt to the surprise of the Bhaurs.

As a result, the Bhaurs sought to set aside the initial settlement by Safe Investments UK of the employee benefit trust on the grounds of mistake. Three mistakes were identified:

1. Firstly, tax – the Bhaurs thought that the EBT loophole would save IHT, and that if the scheme did failure, it would only be that IHT which would become payable, rather than a larger loss being created.
2. Secondly, the honesty of their advisors – the Bhaurs mistakenly thought that the advice given was in their best interests and the trust structure would be administered in their interest.
3. Thirdly, retention of control – the Bhaurs thought they would be able to retain control of their properties despite the structure.

Judgment at first instance

The judge found that there was no relevant mistake. It was clear, that:

1. The Bhaurs knew they would be losing control of their assets. Despite the dishonest advice given to them, what they were told would happen, did happen.
2. The Bhaurs miscalaculated the damage they would suffer if the scheme went wrong. That was a misprediction and not a mistake.
3. The Bhaurs knew there was a mismatch between what they had been told the trust would be and what their expectations were.
4. The scheme was inherently tax evasive, and the Bhaurs were aware of and complicit with the dishonest window dressing done by their advisers.

Judgment of the Court of Appeal

The Court noted (at para 56) the general requirements of a claim in mistake as set out in *Pitt v Holt* [2013] 2 AC 108, namely 1) a mistake which is 2) of the relevant type and 3) sufficiently serious so as to render it unjust or unconscionable on the part of the donee (here, Safe Investments UK) to retain the property given to them.

The Court of Appeal considered that whilst misprediction could still be a bar to relief for rescission for mistake, it did not need to deal with that fine distinction since the primary question in this case was in the third limb of the test, which had been adapted from *Ogilvie v Littleboy* (1897) 13 TLR 399 and involved determining whether "*it would be unconscionable or unjust for a donee to be permitted to retain the benefit of a gratuitous disposition by a person who has deliberately run the risk that the scheme of which the disposition forms part might not work*" (paragraph 85). The court needed to form a view as to the merits of

the case generally when assessing that unconscionability. The Court also noted the comments in Pitt v Holt. as to the possibility of relief being denied in cases of "*artificial tax avoidance*", either on the grounds of misprediction or general public policy.

The Court considered that even if the Bhaurs were operating under a mistake rather than a misprediction (so that the first and second limbs of the Pitt v Holt test were fulfilled) *and* were innocent of any tax evasion, the appeal still had to fail:

1. Whilst the consequences of refusal would be significant (the IHT bill could be larger than the estate) the Bhaurs had chosen to implement what they knew was a tax avoidance scheme and which they knew carried a risk of failure. They had therefore deliberately run the risk; even if it was not characterised as a misprediction (para 101).
2. It was "*of considerable weight*" that the scheme in question was "*entirely artificial*". There was no intention to generally benefit "*employees*", or anyone outside the Bhaur family as was the normal intention with an EBT (paras 102 and 103).
3. The tax avoidance was not unlawful, but a "*social evil*" which was a very weighty factor against relief (para 105).

As a result of these factors, it was not unconscionable for the donee to retain the results of the disposition. The Court also considered that the mistake as to the honesty of the Bhaurs' advisors could not be a mistake for the purposes of setting aside a disposition to a third party, and that there had been no mistake by the Bhaurs about the control of their assets. They had known they would give up control, but presumed that those in control of the assets would act differently.

Wider considerations

This case is a useful barometer for the courts' continuing negative views on tax avoidance. Unlike *Dukeries Healthcare Ltd -v- Bay Trust International Ltd* [2021] EWHC 2086 (Ch) as discussed in this article by Fenner Moeran KC, the judge at first instance here did have sufficient information about the Bhaurs' state of mind to conclude on the evidence that they had taken a risk deliberately, *and* that the Bhaurs had colluded with the tax avoidance. As the court had evidence of the Bhaurs' awareness of the risks, this was not a case where relief was denied solely on the public policy considerations of tax avoidance, despite the highly artificial nature of the scheme. Indeed, although the tax avoidance was

important in the analysis, this was as a factor of unconscionability *after* the court had decided on the Bhaurs' evidence that the risk had been deliberately run.

Similarly, whilst the tax avoidance was a weighty factor, it is not clear how much the end result would have been different without it – there would still have been the clear evidence of the risk being run, although without tax avoidance it would have been harder to say that refusing relief would be "*unconscionable*". There is clear evidence of a trend of courts being slow to grant relief in cases involving tax avoidance schemes, following the dicta in *Pitt v Holt*. Judging how far that trend extends seems likely to require further cases; in particular, the obvious gap at present would be a case with more evidence than in Dukeries so that the Court cannot rely on the applicant failing to meet the evidential burden, but less evidence than in *Bhaur* where the Court considered it could safely conclude that the risk *had* been deliberately run. Any trend that does emerge may well be quite fact specific, given the acceptance by HMRC in *Van der Merwe v Goldman* [2016] EWHC 790 (Ch) at [42] that in that case, relief could not be denied merely on the basis of tax avoidance.

Practitioners outside of the realm of tax may be happy to note the Court of Appeal's uncertainty and disinclination to deny relief on the basis of a misprediction, but without further clarity as to where the line falls, or its removal, it will remain difficult in fringe cases to accurately advise whether there has been a mistake or a misprediction. In particular, cases without a tax avoidance angle are likely to have to interrogate the difficult distinction more thoroughly, despite the Court of Appeal acknowledging that the application of the test can be problematic.

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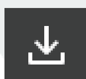

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