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'Mistake' in Dutch private clients practice: the autonomy of parties revealed

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Abstract

When comparing the case law of Hastings Bass, and the more recent UK decisions on the doctrine of mistake, with the concept of mistake in Dutch civil law, it can be concluded that mistake in Dutch civil law has a more expansive application, since it is based on the general principles of contract law.

Rather than avoiding a contract for mistake, parties are able to amend the consequences of a contract, thereby avoiding the consequence of annulment of the agreement. This provides, in practice, a powerful tool to 'redo' complex estate planning transactions in situations where parties can be brought to consensus on the renewed transaction.

In conclusion, mistake is not a 'get out of jail free card' in all cases where taxpayers seek to avoid the fiscal consequences of their ill-advised actions. Nonetheless, this is a device that is often overlooked as a powerful remedy. It is in all events a sophisticated solution and should be handled with professional caution.

Introduction: the basis of Mistake in (Dutch) civil law is in contract law

Being a Dutch and therefore continental ('civilian') lawyer, and having read relevant literature on landmark decisions such as *Hastings-Bass* and *Futter v HMRC* and *Pitt v HMRC*, it strikes me first that in order to clarify the relevant distinctions with civil law on the doctrine of 'Mistake' we need to go back to the gap that divides all legal systems derived the English common law from the legal systems of the European continent ('civilians').

The gap is revealed by asking this question: can a fully capable person make a binding promise to another to give or do something without any consideration? For countries within the sphere of influence of the English common law the answer would be, as I understand roughly speaking, no.

And indeed, for the civilians, the answer is yes. A simple contract does not need to have a consideration *at all*, a contract may have unilateral obligations, such as a donation contract or gift agreement.

Consideration that is required to enforce a simple contract according to English law is defined as:[1]

> A valuable consideration, in the sense of the law, may consist in some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss, or responsibility given, suffered, or undertaken by the other.

A promise, like a gift, is therefore not a contract, however may be enforced presumed it is made by deed.

The same is true for agreements 'in equity', like the agreements that are part of the settlement of trusts.

Since private clients practice consists to a large extent of gifts, trusts, and of course testamentary

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1. *Common law & Civil law, C.AE. Uniken Venema/Zwalve* (W.E.J. Tjeenk Willink 2000) 471.

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dispositions, the rules of contract law are not applicable to this extent in the legal systems that stem from English common law.

In 'civilian' legal systems like the Netherlands civil law however, a donation is a contract without consideration, that aims to enrich the donee at the expense of the donor (Article 7:175 par 1 Civil Code). The donation or gift agreement is a species of a contract and the general rules of contract law apply equally to donation agreements.

A gift may also be included in an agreement with respect to a third party (Article 6:253 Civil Code). The essential feature of a third party clause is that the stipulator transfers funds to a promissor who undertakes to serve a third party. In the context of a gift agreement, a donee agrees to the donor that it will serve certain interests of third parties. The third parties need not have been designated yet, nor need to have been in existence at the moment the agreement is stipulated. Moreover, the appointment may be contingent on the expressed intent of the donor in the future or, alternatively, of the board of directors of the donee.

In civil law, the stipulation of a third party clause is deemed to be a gift from the stipulator to the third party. The third party clause may be revocable or irrevocable, but ultimately becomes irrevocable at the moment the designated third party has accepted the clause.[2]

A gift agreement may also include the obligation for the donee to meet an *encumbrance* (*last)*—without remuneration—towards a third party. Essential element of this type of gift is that neither the donor, nor the third party have the power to enforce the 'last'. This is not a type of clause that may be applied in any agreement, but is a specific tool provided for under the Inheritance and Gift Law.[3] A gift with encumbrance may benefit a third party, but it never gives a concrete entitlement to a third party. If the recipient of a gift with encumbrance (*schenking onder last)* breaches the encumbrance stipulated by the donor, the donor may nullify the entire gift.

Since an important change in Dutch tax law, the Dutch Private Foundation has become a highly attractive device for dynastic structuring of international wealth. The combination of a foundation according to Dutch law, which is a robust legal entity and may have a Controlling (Family) Board, and the transfer of assets by way of a gift agreement between the 'settlor' and the foundation, provides for 'solid' asset protection and a unique tax treatment for international families.[4] Consequently, the rules of contract law will apply to the transfer of wealth to a Private Foundation.

Mistake in Dutch contract law

Mistake according to Dutch law may be defined as an erroneous assumption relating to relevant facts or to law existing when a contract is concluded. Mistake should be distinguished from a misunderstanding; in the first situation there is consensus, but the will of at least one of the parties has been realized by mistake whilst in the latter situation there is *discensus*, a lack of consensus. In the latter case, the general effect is that there has not been concluded any agreement between parties.

Article 6: 228 Civil law provides that a contract may be avoided or annulled for mistake, if the contract was not concluded (on materially the same terms) by the party in error if the true state of affairs had been known, and the other party made the same mistake, or caused the mistake, or knew or ought to have known of the mistake and ought to have informed the party in error.

However, a party may not avoid the contract if the mistake relates to an assumption to a relevant fact in the future, or to a matter in regard to which the risk of mistake was assumed or, having regard to the character of the contract, reasonable commercial standards and the relevant circumstances, should be

2. Art 6:253 (2) Civil Code.
3. Art 7:184 (1)(a) Civil Code.
4. See Dr Ineke A. Koele, 'The Dutch Private Foundation: a Robust but Flexible Tool in Dynastic Structuring' (2014) Trust & Trustees.

borne by the mistaken party (Article 6:228 par 2 Civil Code).

Once the contract being declared void, the contract will be deemed not to have existed at all; the rescission has effect *nunc pro tunc*.

What is of great practical importance, is that the possibility to rescind or avoid a contract for mistake no longer exists if the other party timely proposes an amendment to the consequences of the contract, that reasonably compensates for the disadvantage of the mistaken party in relation to the maintaining of the contract (Article 6:230 Civil Code). In practice, this may be often used as a way to change the consequences of a contract between parties in a binding way, also with effect towards third parties such as eg the tax administration.

When a contract is rescinded on the basis of mistake, the rescission can be invoked by a declaration (orally or in writing) by the mistaken party to the other party (or parties) within a period of three years after the mistake has emerged. Where a real property is concerned, the rescission can only be effectuated outside the Court if all interested parties consent to the declaration of rescission. Alternatively, the rescission can be issued by a Court.

Also, the Court is able to *convert* the consequences of a contract instead of declaring the rescission of the contract.

Future changes: no mistake, but 'change of circumstances'

Where situations change in the future, Dutch law provides for the possibility that upon request, the Court can decide that a contract should be amended or discontinued based on circumstances that could not be foreseen at the moment the contract has been concluded (Article 6:258 Civil Code).

Equity in contract law (Redelijkheid en billijkheid)

Where law systems based on Anglo American law distinguish between 'common law' and 'equity', in the civil law systems normally the denomination of 'reasonableness' or 'equity' is a key element of the legislation on contract law and accordingly, directly applies to contracting parties. Also, it is an important source of interpretation of contracts by the Courts as well.

In the Dutch Civil Code, it is explicitly provided in Article 6:248 paragraph 1 that a contract between parties bears also legal consequences that follow from the requirements of 'reasonableness and equity'; this is referred to as the *complementary application* of reasonableness and equity.

In the second paragraph of article 6:248 Civil Code, it has been added that a contractual provision agreed between parties is not applicable, to the extent this would be unacceptable according to the criteria of reasonableness and equity in the given circumstances. This is referred to as the *restrictive application* of reasonableness and equity.

Sanction of a void transaction (convalescence)

It should be distinguished from the doctrine of mistake that transactions, that are void since they were not formalized correctly, may be sanctioned with retroactive effect by the remedy of sanction, ex Article 3:58 Civil Code.

Spontaneous mistakes

In order to provide some examples of mistakes and the consequences of its remedies, also vis-à-vis third parties, I will highlight some interesting but easy to understand cases from Dutch private client practice. For the purpose of this contribution, the mutual 'spontaneous' mistake where both parties made the same mistake, is the most apparent form of mistake.

Unnecessary to say, the doctrine of mistake provides for a very suitable tool to 'redo' complex transactions in estate planning, where erroneous mistakes by families and their advisers can be said to have been the source of flawed structuring. Since the timely and adequate proposal of an alteration to the contract that reasonably compensates for the disadvantage of the

mistaken party solves the validity of the contractual relationship, this provides ample opportunity to 'redo' complex estate planning schemes without adverse consequences. This possibility to restore an agreement that has been entered into by mistake, explains as well that there is limited case law on this subject and that parties more easily can solve the issues that arise from mistaken contracts. Where donation contracts are used for the transfer by wealthy families to Private Foundations, the concept of mistake that is relevant to the donation contract provides a comfortable level of flexibility between the contracting parties, ie the donating family and the recipient foundation. In practice, though, more elaborate provisions such as 'conditions' and 'encumbrances' are added to the contents of a donation contract with a foundation in order to provide flexibility and guidance for the future. In combination with the application of corporate law to the foundation—that may provide the Board with eventual consent of the Supervisory Board with the power to amend the constitutional documents of the foundation—and the oversight by the family through a controlling board over the operations of the foundation, this creates a robust but flexible legal device with a desirable level of 'checks and balances' to diminish the risk of conflicts within the family.

Mistake in donation contracts

Where gifts are made between family members on the presumption of legal structures and its consequences that determine their relationship, that in a later stage for whatever reason do not seem to be right, this may be a reason to rescind the gift agreement.

In Dutch case law, we have seen some cases where the tax authorities did not accept the consequences of the rescission for tax purposes.

In 2007, the Court of Arnhem[5] decided on a case where a man and a husband waited for two years after the start of their cohabitation before they formalized a donation contract between themselves, based on the presumption that after two years the lowest applicable gift rate would apply them (being considered as 'related to each other'). They had obtained confirmation on this presumption from a notary and an accountant. When later on, this presumption appeared to be mistaken, and consequently the gift attracted the highest applicable gift rate, they 'avoided' the donation contract by a declaration and the donation was repaid.

If the donation contract was rightfully annulled for mistake, the gift tax that had been paid already could be reclaimed.

This is where the tax administration denied the repayment of the gift tax. The Court decided that it was likely that the couple would not have concluded this donation contract if they were not mistaken on the relevant tax rate that would apply to the gift between themselves and hence, there is a causal relationship between the mistake and the donation contract. The tax authorities argued that in this particular case, the risk of mistake should be borne by the mistaken party (with reference to Article 6:228 par 2 Civil Code). However, the Dutch Supreme Court decided back in 2002 in a similar case[6] that a third party such as the tax authorities, which is not a contracting party, is not able to invoke this exception which is meant to provide for a rule of risk of mistake between contracting parties. If, eg, one party is mistaken by a wrongful advice of his lawyer, the other party is able to invoke the exception since between the two parties, the risk of mistake should reasonably be borne by the mistaken party that has obtained a wrongful advice. However, where both parties are mistaken based on a wrongful advice of one or more lawyers, or alternatively, where the other party does not object against the rescission of the contract for mistake, there is no principled argument for the tax authorities to object the validity of the rescission based on the argument

5. Court of Arnhem, 9 August 2007, BB2403, V-N 2008/2/29.
6. Hoge Raad 12 July 2002, BNB 2002/313 re real property transfer tax.

that the risk of mistake should be 'borne' by the mistaken party. There is no disadvantage for the tax authorities in this approach, since the donation has been annulled.

The result therefore is that the rescission for mistake of a contract has effect towards the tax authorities if the contracting parties consent to the rescission. This is, however, not true where parties collusively agreed to a rescission. The onus of proof that parties have agreed in collusion to a rescission, in principle is on the tax authorities.

A similar result was obtained in the case where a donor entered into a donation contract with a newly created association based on the (erroneous) assumption that the recipient was qualifying as a charity for tax purposes and hence, a substantially reduced gift tax rate would apply to the donation. The donation contract determined that all relevant costs would be borne by the donor. The Court[7] decided that both parties were mistaken and considered it likely that the donation contract would not have been concluded at all, or at least on similar conditions, if the erroneous assumption would have been clarified. The result of the mistaken contract was its rescission, as a result of which no gift tax at all had become due. The tax authorities had to repay the gift tax, since the donation was nullified.

Mistake in testamentary dispositions

In classical Roman law, the basis of civil law systems on the European continent, mistake in the assumptions underlying testamentary dispositions in a Will were not relevant at all. This is shown by the phrase: *Falsa causa non nocet,* which may be translated as: a false assumption does not harm.

The Dutch civil law system is a notarial system and the use of profession of notaries who have a semi-public function is an important tool for the legal certainty on the validity of a Will. A notary is responsible to assess the capacity of a testator, to avoid that a Will is made under undue influence and to discuss the legal and tax consequences of the contents of the drafting of testamentary dispositions in a Will.

The Dutch Civil Code still provides for limited possibilities of remedy in cases of mistake of assumptions by the testator. A Will that is made under the influence of a false assumption, can only be nullified, if the Will reflects the erroneous assumption of the testator and the testator would not have made the disposition if the true state of affairs had been known at that time (Article 4:43 par 2 Civil Code). Although we would assume that notaries would frequently write 'considerations' of a testator in Wills, expressing assumptions and intentions, this however is not the general practice of notaries that are exclusively authorized to write Wills in the Netherlands.

Nonetheless, in the legal practice Courts are increasingly willing to 'interpret' the contents of a Will in accordance with the principles of 'reasonableness & equity' and in practice, assumes situations where a testator has made testamentary dispositions on erroneous presumptions that count for mistake.

The law provides for guidance on the interpretation of Wills, in Article 4: 46 Civil Code:

(i) In the interpretation of a Will, the relationships that are intended to be covered by the Will and the circumstances under which the Will has been formalized, have to be taken into account.
(ii) Acts or declarations of the testator outside the Will may only be used for the interpretation of the contents thereof, if the wordings have no meaningful purpose.
(iii) If the testator has made a mistake in the determination of a person or asset, the Will may be executed after the intention of the testator, if the intention can unequivocally be demonstrated by the Will or by any other means.

7. Court Haarlem, 18 January 2007, AZ7209, V-N 2007/47.21.

In a higher Court case dated 9 September 2002 (Hof 's Hertogenbosch, NJ 2003/446) a notary has made a mistake in drafting in a Will a revocation clause. After the decease of the testator, the notary stipulates a rectification deed with his explanation. Nonetheless, the Court considered the words of the Will to be 'clear' and the claim of the heirs that were appointed in the first Will was turned down.

Since that, very formalistic, approach, our case law has developed into a framework of 'interpreting' the intention of the testator by all means and in appropriate cases, a framework of 'reasonableness' as to the legal consequences of the Will.

This is perfectly illustrated by a recent case of the Supreme Court of 11 October 2013, where a woman had drafted a Will with the appointment of her brother as sole heir. Years later she married in a community of property but did not change her Will before she died. Her husband and brother both claimed (half of) her estate.

In first instance, the lower Court decided that the Will was clear, the wordings have a meaningful purpose and consequently, her brother was the sole heir. However, before the Court of Appeal it was demonstrated that the woman was living with the false assumption that her Will was not valid any more since she was married in a community of property and that initially, it was her desire (before she married) to avoid that her parents would be inheriting from her. The appointment of her brother was in fact an implicit disinheritance.

The Supreme Court decided that the Will should be interpreted such that the appointment of the brother as sole heir was applicable in the situation that there was no alternative to disinherit the parents of the woman. Once she married, there was an alternative and the Will was declared non-existent.

Where the lower Court decided that it was contrary to the principles of 'reasonableness & equity' to obey the legal consequences of a Will that has only been maintained due to mistake, the Supreme Court comes to the same result however by using arguments of construction of the Will.

As a consequence of this development, it is likely that in Dutch private clients practice, the frequency of litigation on the interpretation of Wills is to increase.

Apart from this, the law provides for some remedies where legal instruments are not apt any more in a changing legal environment. In the situation where a complex Will was drafted with the aim to save substantial inheritance tax for future generations (through the use of the so-called 'me-grandfather' clause, a type of generation skipping), the later amendment to the Inheritance Tax Act in 2010 frustrated the effectiveness of this clause. Upon request of the heir, the clause was rectified by the Court, taking into account all personal and public interests, and taking into account the original intention of the testator, based on a provision in article 4:145 Civil Code to this extent. The Court annulled the ineffective clause that had not longer the intended effect of the testator.[8] In this decision, the Court explicitly stated that it is a legitimate interest for families to structure their affairs so as to minimize tax and assisted the family in amending the disposition according to the original intention of the testator.

Tax consequences of declarative agreements (Settlement Agreements or Formal Compromise Agreements)

The Dutch Civil Code has a general concept of a Settlement Agreement. Parties in complex legal circumstances, such as family members with different interests in family enterprises and/or estates, may enter into a settlement agreement in order to finalize or to avoid uncertainty or conflict on their internal legal relationship, and to declare the legal relationship between themselves, intended to apply as well to the

8. Court of Maastricht 29 August 2012, ECLI:NLRBMAA:2012:BX6252.

extent this may deviate from the original legal position.

In private clients practice, this is a very powerful tool to resolve muddy situations in complex families. With a creative perspective on the situation, even a hypothetical relationship may be sought to declare by way of settlement, in order to reach a result that is acceptable to all parties.

We find settlement agreements of all sorts, including agreements on conflicts with the tax authorities. Settlement agreements may very well be used to remedy mistakes, but are the result of negotiations between parties.

Since the tax law generally follows the legal relationships of persons, generally speaking a settlement agreement will also have effect vis-à-vis the tax authorities. The tax authorities generally will follow the legal consequences that result from a settlement agreement between parties, and it follows from Dutch legal doctrine[9] that the tax authorities may deviate from the legal reality resulting from a settlement agreement only if (i) parties settle an issue that is not in their power to settle such as eg the existence of a marriage or (ii) the settlement agreement is a collusion between the parties.

If the doctrine of mistake is not applicable due to the restricted scope of this doctrine, eg where the complexity of the situation is the consequence of circumstances that have become apparent in a later timeframe such as new tax legislation or alternatively, where the contracting parties have been informed on certain uncertainties of their actions by their lawyers or advisers, the possibility of a Settlement Agreement may be a very practicable tool to terminate any legal uncertainty between the parties.

Conclusion

When comparing the case law of *Hastings Bass* and the more recent UK decisions with the concept of mistake in Dutch civil law, it can be concluded that mistake in (Dutch) civil law has a more expansive application since it is based on the general principles of contract law.

In Dutch civil law, likewise there is no distinction between mistake as to consequences or to effect of a voluntary transaction, since both may count as mistake. Moreover, it is irrelevant whether a mistaken party has acted in breach of a fiduciary duty by doing so. And furthermore, the degree of mistake is not decisive in the Dutch civil law contractual concept, where ignorance, forgetfulness, inadvertence, or misprediction are not distinguished in this context.

The transfer of properties without consideration to a wealth planning device such as a Dutch private foundation is qualifying as a donation contract and therefore subject to the rules of mistake. However, in testamentary dispositions, there is a traditional restrictive application of mistake which however is rapidly changing.

The concept of mistake is not suitable for avoiding contracts that have been entered into by parties that were conscious of certain risks or uncertainties as to the effects of the agreement. *A calculating party is not mistaken*. However, in order to terminate an uncertainty as to the effects of an agreement, parties are able to agree on a further settlement agreement.

While there is no special attention given to 'artificial' tax avoidance schemes,[10] the bottom line however is that the tax authorities are not bound to recognize collusive avoidance of contracts for mistake or collusive settlement agreements between contracting parties in order to terminate uncertainties between them. The fact that the tax authorities are not a party to the agreement is not decisive in this respect.

Rather than avoiding a contract for mistake, parties are able to amend the consequences of a contract and thereby avoiding the consequence of annulment of the agreement. This provides in practice a powerful tool to 'redo' complex estate planning transactions in situations where parties can be brought to consensus on the renewed transaction.

9. Dutch Supreme Court 19 September 1990, NJ 1992/649.
10. Reference is made to the obiter consideration of Lord Walker in the *Pitt v Holt* case, para 135.

In conclusion, mistake is not a 'get out of jail free card' in all cases where taxpayers seek to avoid the fiscal consequences of their ill-advised actions. Nonetheless, this is a device that is often overlooked as a powerful remedy. It is in all events a sophisticated solution, and should be handled with professional caution.

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