# Taxing Matters

Navigating the complexities of the tax world

RPC

## Season 3

# Episode 11 – When tax advice goes wrong: professional negligence in tax disputes with Helen Kerr and Tom Wild

**Alexis:** Hello, and welcome to Taxing Matters, your one stop audio shop for all things tax brought to you by RPC. My name is Alexis Armitage, I am a senior associate in RPC's Tax Disputes team, and I will be your guide as we explore the sometimes hostile and ever-changing landscape that is the world of tax law and tax disputes. Taxing Matters brings you a roadmap to guide you and your business through this labyrinth. In case any of you miss any crucial information or just want some bedtime reading, there is a full transcript of this and indeed every episode of Taxing Matters on our website at www.rpclegal.com/taxingmatters.

This episode explores how professional negligence claims can arise during the life cycle of a tax dispute. From initial advice through HMRC investigation to litigation, it will examine where advisers, particularly lawyers and accountants face exposure to claims, how these risks are assessed and what lessons can be learned for both practitioners and insurers. I'm delighted to be joined today by two of my colleagues at RPC, Tom Wild and Helen Kerr, who specialise in this area.

Tom focuses on advising law firms in connection with claims arising out of corporate and finance transactions, derivative transactions, cryptocurrencies, pensions, commercial property transactions, tax and financial services regulatory advice.

Helen specialises in professional liability, particularly in defending claims against solicitors, barristers, accountants, auditors and insolvency practitioners. She also advises professional firms in relation to regulatory investigations and disciplinary proceedings.

Thank you both so much for joining me today.

**Tom:** Yeah, thanks for having us, Alexis.

**Alexis:** So to kick things off then, Tom, why is this an important topic?

**Tom:** Well, first off, tax advice is complicated and often has big numbers attached to it, if it goes wrong. So it's a high risk area for claims. Obviously the tax adviser gives negligent advice or misses a filing deadline and their client suffers loss as a result, a claim is likely to follow. And what's more, tax liabilities can give rise to claims in lots of other situations too. So, for example advisers on a corporate restructuring, which gives rise to adverse tax consequences might find themselves facing a claim arising out of tax liabilities, without potentially thinking about tax at all.

**Alexis:** So Helen, to understand where negligence can creep in, let's walk through some of the sort of typical life cycle of a tax dispute, shall we?

**Helen:** Yeah, of course. I was going to start by saying that tax disputes start at the point at which the initial piece of advice is given. But actually, the seeds for a negligence claim are usually laid quite a bit before that, at the point at which the adviser is engaged. At that stage, it's really important for any adviser to accurately describe what tax advice they're going to be giving and more importantly what tax advice they're not going to be giving and to whom. So for example if your advice is limited to UK tax advice you must say so before it's given. If it's limited to completing a tax return based on information that's been received, sometimes limited, then definitely say that or perhaps if you're giving tax advice to an individual and not a company or vice versa, make sure that's set out in the initial scope. It's at this point that a clearly defined scope can really help if there are problems later down the line. Moving on to the next stage where claims can creep in. This is at the point when HMRC might open an inquiry. So here, tax advisers need to manage the relationship with HMRC on behalf of the client, but they also need to manage their own client as well as their own position. Things can change quite quickly and that's especially the case if HMRC are indicating that they might be taking quite an aggressive position. Missteps like not properly disclosing information to HMRC or not properly keeping the client informed and managing their expectations can cause issues at this stage. Tax advisers need to be careful to consider how they deal with the inquiry. If there's any suggestion that HMRC are taking a different view, perhaps it's worth thinking about whether professional indemnity insurers ought to be involved at that stage to make sure that they're happy with the way in which you're communicating with HMRC and with the client.

Moving on then to if HMRC do decide to issue an assessment or issue penalties, things are clearly escalated by this stage. Just remember that a tension can evolve between a tax adviser and their client at this point there is an error in the amount of tax that has been paid. HMRC are less likely to issue a penalty or your client might have a better chance of challenging the penalty if the tax adviser can show that they took reasonable care in completing any tax return and calculating the tax that's payable. So it can sometimes be in the client's interests for any error that's been made to be attributed to the adviser. But of course, tax advisers have got to be 100% transparent with HMRC about what's happened and they must also ensure that they don't jeopardise their own insurance cover by conceding any wrongdoing without the proper consent of their insurers. Turning then to the final stage perhaps where a decision is taken to formally challenge HMRC either via court proceedings or via some form of formal appeal. Remember that an appeal to the tax tribunal is going to be looking at what advice was given to the taxpayer in quite considerable detail. If the court case is lost, the taxpayer might be looking to put the adviser on the hook for legal costs, which can sometimes be substantial. Even if an appeal is won, the adviser isn't always off the hook. If there's been inadequate advice around risk, the adviser could still face a negligence claim.

Looking at each stage, the role of the adviser shifts from before the advice is given all the way up to perhaps challenging any determination handed down by HMRC. The exposure to claims is often likely to grow as time goes on.

**Alexis:** Thank you, Helen. Tom, what are some of the sort of common scenarios where negligence arises in these sorts of cases?

**Tom:** Well, negligent tax advice is the obvious category and that can of course include advice that's simply wrong. But quite often it can also mean advice that doesn't properly inform the client of the risks that they're taking. There's quite an infamous example where a lawyer gave advice about an aggressive scheme to avoid CGT and IHT through an offshore trust. And the efficacy of the advice turned on the construction of a provision in the inheritance tax act.

Now the Court of Appeal agreed that the adviser's construction of the Act wasn't itself negligent. A reasonably competent solicitor could have read it in that way. The problem was that the construction, while possible, was unlikely and the adviser didn't go on to tell the client that they were effectively gambling on a possible but quite unlikely outcome, with nasty consequences if HMRC disagreed. So that's one clear risk in this area, not giving your client a steer as to the risks involved with a particular strategy and the chances of it not working. Another risk is the one I mentioned earlier, where advisers make a mistake on a transaction which has tax consequences for the client. They might not be advising on tax at all, but still find themselves exposed to a claim in respect of tax liabilities. We sometimes see this happen when you've got multiple advisers who assume incorrectly that someone else is taking responsibility for a particular step, or where they assume that everyone's on the same page with regards to strategy when they're not.

Other risk areas are things like missing filing deadlines, missing appeal deadlines, clerical errors in tax returns. Those are always very common reasons for claims.

**Alexis:** So Helen, let's dig into how the courts actually assess negligence in this context. What are the sort of relevant legal tests and standards that we're looking at here?

**Helen:** Yeah, of course, I'll speak at a bit of a high level really and not try to dig too much into the ins and outs of case law. We all know that it starts off by assessing whether there is a duty of care on the part of the adviser to the client or a another. Usually it's clear there's perhaps a contractual relationship which is entered into via an engagement letter and in those circumstances is usually a concurrent tortious duty owed by the tax adviser to their client. But we often see in these sorts of claims, non-clients who claim to be relying on tax advice that's been given, perhaps given by the adviser to a tax scheme promoter or in some other circumstances. If there's a non-client, court will look at whether the adviser assumed a responsibility to advise that non-client, either by their words or their conduct.

Here it's likely to be a question of whether it was objectively reasonable for that non-client to rely on the advice given and whether it was objectively foreseeable by the adviser that they would do so. If a duty is established, the question will then turn to whether the duty was breached.

It's not just a question here of whether the tax advice was wrong. It's about whether, objectively, a reasonably competent adviser with the same level of skill or experience would have given the same or materially similar advice. So specialists will be held to slightly higher standard. The question of whether the advice was caveated or risk warnings were given is always going to be key here. It's amazing how many times we've seen advice given or tax returns being submitted where the adviser has not told the client that HMRC might take a different view. We also see instances where there's a significant time pressure towards the end of year end. A client might be putting pressure on an adviser to give certain advice or submit a tax return which can lead to errors. Usually the court will give very little credence to arguments of this sort. It's important to think here as well about other types of circumstances where tax-related claims can arise. This is for example transactions where there are tax consequences, but you're not the actual tax adviser. In those circumstances, the court will look at the role of the adviser and consider whether the advice provided was objectively reasonable.

We look then at whether the recipient of the tax advice has suffered any loss, which was caused by a breach of duty by the adviser. In this context, additional tax which becomes payable is not usually a loss because it would always have been payable. The focus areas are going to be interest and penalties which might be charged by HMRC. Although for interest, remember that the taxpayer has to account for any benefit that they have received from having the money in the intervening period. You've also got to consider the costs that the individual or company has incurred in fighting HMRC if a fight ensues. The question is essentially what would have happened but for the breach? If there is a tax relief that's been missed, then the losses can sometimes be substantial because the individual or company will have paid tax, which otherwise could have been avoided.

**Alexis:** Great, thanks Helen. So Tom, what is the role of insurers in these types of disputes?

**Tom:** Well, professional indemnity insurers are the parties who ultimately pick up the tab if a claim's made. They're the ones who fund the defence of the claim. And if a claim succeeds against the professional, they'll be the ones who are picking up the damages award. So it's a high risk area for claims, they can run into really big numbers. So this is an area where insurers want to be really clear as to the risks that they're taking on. I think we're going to come on to speak a bit later about some of the things that insurers can do to manage risk in the tax area. Assuming a claim has been made, the first question an insurers likely to ask is whether the risk in question is covered under the policy. I wouldn't dream of trying to get into the complexity of insurance coverage here, but there are lots of scenarios where it can become an issue. For example, anything to do with tax fraud is likely to give rise to questions about cover. Assuming cover is engaged, insurers are going to be the ones funding the defence of a claim, and he who pays the piper, they'll be supervising how it's conducted as well. That's an area where you can sometimes see friction between insurers and firms. So for example, a firm might want to settle a claim to avoid adverse publicity or to avoid annoying and an ongoing client. But insurers will be seeing the risk in purely financial terms. But ultimately insurers will be laser focused on wanting to understand the risk of the claim succeeding and the financial consequences of that and what it's going to take to either buy off the risk or fight the claim to a successful conclusion. So that's all to do with professional indemnity insurers. And entirely separately from that, there's an active market for insuring tax risks. And that can often form part of resolving a dispute. For example, rather than waiting to see whether HMRC challenges the tax treatment of a particular transaction, the client might want to take out tax indemnity insurance and recover the premium from their adviser as the damages in the claim. And subject to the terms on offer that can be quite attractive for both the client and the adviser because it can help them to draw a line under what might otherwise be some very many months of uncertainty waiting for HMRC to resolve the issue.

**Alexis:** Brilliant, thanks Tom. And so this is a sort of a question for both of you. What are your sort of top tips for prevention then? Whether you're giving tax advice, assessing negligence or underwriting the risk.

**Helen:** So my top tip goes back to what I think we started off this podcast discussing, which is scope of the advice being given. Scope, scope, scope. Tell the client what advice you're going to be giving, but more importantly, tell them what advice you're not giving. Make sure you include caveats where there's any missing information, perhaps where you think the HMRC could take a different view down the line or perhaps where there are other options for the client to consider. If there are any other advisers involved, such as if you're an accountant or a tax adviser and there are lawyers involved or vice versa, make sure that the client knows exactly who is doing what. Linked to that, I'd say document everything, especially any advice around risk or where you're advising on alternative options. Don't be tempted to stray outside of what you've said you're going to do, particularly what's been agreed in writing, and make sure you keep your own records of why you're giving certain advice, for example, why a relief claim may or may not be available, why a deadline has been extended, etc.

**Tom:** Thanks Helen. I've thought a little about the same question in the context of insurers and how they can manage their exposure to tax risks. First and foremost, they're going to be wanting to try and avoid their insureds facing claims in the first place. And the sort of things that insurers can and will be doing in that regard is things like ensuring firms are giving appropriate regular training to their people. They might audit engagement terms to make sure they're happy the professional's scoping appropriately and limiting their exposure to claims. They might want to ensure that firms have got things like file review procedures, appropriate supervision arrangements in place, screening processes when onboarding clients to identify high risk clients. Really anything that helps reduce risk at the level of the insured, and then separately, insurers are also going to be looking at the market, looking at claims, both the claims experience of their insureds, decisions, emerging trends in the market, to form a view as to the level of risk they're taking on when writing cover. So for example, right now, I think a lot of insurers are probably going to be thinking about things like the risk associated with the use of AI and legal advice and how that is going to impact their insurance.

**Alexis:** Thank you so much. That's all we have for today's episode. Thank you again to Tom and Helen for joining me. If you're an adviser, lawyer or insurer, we hope this helped you to see how tax disputes can quickly turn into professional negligence claims and how to guard against that. See you next time.

**Alexis** As ever, a big thank you goes to RPC's in-house team for the production, music and sound editing of this episode.

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