A changed climate

Is stormy weather approaching for tax avoidance schemes? SIMON MCKIE suggests measures promoters might take to ensure they are waterproof.

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Avoiding tax is unpopular at the moment. The unfortunate staff of Vodafone, Top Shop, HSBC, Barclays and even Boots have seen their stores targeted by demonstrators confident of their ability to understand the complexities of corporate taxation. HMRC have been strident in their condemnation of legal tax avoidance, deliberately eliding the distinction between such avoidance and criminal tax evasion. The government feels called upon to 'consult' on a general anti-avoidance rule (GAAR) although it too seems unable to distinguish between avoidance and evasion, having provided an extra £900 million to combat one or the other – it doesn't seem clear as to which.

The courts are not uninfluenced by fashions in public opinion and in recent years they have shown themselves determined to find against tax planning schemes regardless of the violence which they must commit against the statutory language to do so. However, when many of those schemes were implemented in the early years of the millennium, there was a very different climate for tax avoidance and the schemes often seemed to have good prospects of success. Pre-packaged schemes were eagerly marketed, not only by their creators and imitators, but also by a host of intermediaries including many of the leading firms of solicitors and accountants as well as a number of the large banks. Now that many of those schemes have failed, it is natural that the taxpayers concerned will wish to consider whether they can recover their losses from those who advised them to implement the schemes. Those advising such clients will wish to know whether they might themselves be the target of such claims and whether their clients have viable claims against their other advisers.

KEY POINTS

- Recovering the costs of failed tax-planning schemes.
- Which costs might be recoverable?
- What contractual terms applied and was the advice of the required standard?
- The importance of counsel's opinion.

Damage and defendants

Of course a successful claimant will not be able to recover the tax which he hoped to save under the scheme for this will normally be a cost he would have borne even if correct advice had been given. Sometimes, participation in a scheme which has failed may actually have increased the participant's tax liability and this would certainly form an element of the damages sought by a claimant. A claimant will hope to recover his transaction costs, the fees he has paid for the advice, any tax penalties he has suffered and, also, a sum in respect of interest on late payment of tax. Any such interest element, however, would take account of the fact that the claimant had had the use of the money he would otherwise have paid in tax at an earlier date. It would also take account of whether he had mitigated his loss by buying a certificate of tax deposit, or making a payment on account, when it became apparent that the scheme was likely to fail. Damage arising from the client's loss of the opportunity to reduce his tax liability through other means poses difficult problems of evidence and quantification, but may also form a part of some claims.

The potential targets of such claims will include the promoters of the scheme, those who introduced the client to the promoters, the client's general tax advisers who may have provided advice or a second opinion in respect of the scheme, and any counsel whose opinion was used to promote the scheme. The claim is most likely to be under the law of contract or of the tort of negligence.

The scope of the engagement

In respect of possible contractual claims, the place to start is to determine the scope of the relevant engagement contract. Promoters may well have carefully defined the services which they were to provide and the degree of reliance which the client could put on their advice. Where the advice was given as part of a continuing relationship, however, it is not uncommon to find that the express terms of the engagement are highly general and their application to the advice actually given very uncertain. One needs to consider any limitation of liability clause the contract may contain and the extent to which a failure by the adviser to direct the client's attention to it makes it unenforceable. It is, of course, common in tax planning strategies for advisers to receive remuneration in the form of commission, particularly if they are acting primarily as introducers. Where that is the case, one might consider whether that commission was properly disclosed to the client in accordance with the rules of the relevant professional bodies. Where the tax planning transactions included a financial instrument, one needs to consider whether, and to what extent, financial services legislation applied to the arrangements.

Advice of the required standard

In an engagement to provide professional advice it will normally be an implied term of the engagement that the advice will meet the standard of competence of the ordinarily competent professional adviser holding himself out as able to provide advice in the area concerned. The advice will not be in breach of that term simply because the scheme has failed. The question is whether the advice would have been given by such a reasonably competent professional adviser who was in the position that the actual adviser was in at the time that the advice was actually given.

To answer that question one would need to consider whether the advice took proper account of the relevant statute and case law at the time, and of the known practice of HMRC (or its predecessor bodies). Did it properly take account of the probability that HMRC would challenge the view of the tax consequences of the transactions taken by the adviser and did it make a reasonable assessment of whether the expected view of HMRC would be upheld by the courts? Did the advice properly communicate that assessment of probability to the client?

There are other points to consider. Did the advice reasonably quantify the risk of loss if the scheme failed? Did it identify the direct costs which would be born by a client in dealing with an enquiry and of appealing to the Special Commissioners or, later, the First-tier Tribunal, and from there to the courts? Did the adviser properly explain the taxpayer's rights of appeal both to the tribunal and to the High Court? Did it deal with the risk of interest being charged on the late payment of tax and of a penalty being imposed?

I have seen advice which simply provided an explanation of how the relevant statutory provisions were expected to apply to the transactions without giving any indication that there is, in all tax planning of this sort, an inherent uncertainty of outcome.

If, at the time the strategy was implemented, there was some actual experience of HMRC's response to returns of transactions taking place under the strategy, did the advice properly summarise that experience? For example, I have known advisers to refer to the submission of a tax return and the failure of HMRC to raise an enquiry into that tax return as the scheme having been 'accepted' by HMRC. Of course, it is nothing of the sort.

Advice and disclosure

Where the scope of the engagement included providing advice on the disclosure to be made of the scheme in the taxpayers' tax return, did the advice take proper account of the need to provide protection against the imposition of penalties and the issue of a discovery assessment? The law of discovery has developed significantly since the period when most such schemes were implemented and so the fact that HMRC have successfully raised a discovery assessment is not, of itself, proof that the advice on disclosure was in breach of the adviser's duties under the engagement.

Where the advice included continuing advice on dealing with HMRC in respect of the scheme and on the conduct of litigation, did it take proper account of developing case law and revenue practice? As litigation proceeded, perhaps through several levels of appeal, did the adviser adjust his assessment of the probability of success in the light of experience? It is common in such tax strategies to have an element of remuneration which is contingent on the outcome of the strategy. If so, did the advice on the conduct of the enquiry and litigation have proper regard only to the interests of the client and not to the interests of the adviser?

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It was common for promoters of schemes to protect their intellectual property by revealing them to potential clients and introducers only on conditions of confidence set out in a confidentiality agreement. That was entirely proper. Usually those agreements will now have no further function because the techniques which they sought to protect will have been disabled by later legislation or become generally known. When an adviser is anxious that his conduct might be subject to criticism he may be tempted to use such agreements to prevent the client from obtaining a second opinion or alternative advice. Apart from the fact that the attempt would almost certainly be unsuccessful, there will be a clear conflict of interest in continuing to provide advice in these circumstances.

Counsel's opinion

Most designers of tax-planning strategies will have taken a detailed opinion from counsel upon them. Normally that will have had a dual purpose. First, it provided additional assurance to the designer that his strategy was robust and likely to be successful, having been reviewed by an independent and objective expert. Secondly, it provided comfort to potential clients that the strategy had been reviewed by an expert who did not have a financial interest in the client implementing it.

The adviser's reliance on the counsel's opinion may provide a substantial defence to a claim that he has been negligent. But that may be dependent upon whether the counsel had the requisite expertise in the areas of law relevant to the strategy. In particular, if the strategy fails on an issue which is not a matter of revenue law, such as contract law, insurance law or land law, did the counsel was an expert in Revenue law also have the requisite expertise in that other area of law? Often an additional opinion will have been obtained from counsel expert in another area of law. In that case, one needs to examine whether the instructions and counsel's opinion properly dealt with those aspects of the matter which were relevant to the tax issues at stake.

> ***"In many strategies a fighting fund was established to meet the costs of establishing the success of a scheme."***

In respect of all relevant opinions, whether they be just on matters of revenue law or on other areas of law as well, one needs to consider whether the instructions were properly drafted so that counsel's opinion was actually obtained on all of the issues relevant to the success of the strategy. Perhaps the very issue on which the strategy failed was one which was excluded from counsel's consideration by the instructions. Were the facts set out in the instructions an accurate and complete account of the relevant facts? Some years ago, I saw a set of instructions in relation to the application of the transfer of assets abroad legislation which stated as a fact that all of the transactions were genuine commercial transactions which were not designed for the purpose of avoiding liability to taxation. It was hardly surprising that counsel was able to say, on the basis of the instructions, that the transfer of assets abroad rules did not apply.

If one concludes that the instructions were inadequate, what responsibility did the adviser have in respect of those instructions? How was counsel's opinion used in persuading the taxpayer to enter into the scheme? What reliance did the taxpayer place on it? Is there a potential claim against counsel?

Fighting funds and expert witnesses

In many strategies a fighting fund was established to meet the costs of establishing the success of a scheme. Was advice provided in respect of those arrangements? If so, did it properly assess the adequacy of the fund and of the arrangements for its operation?

There have always been cycles of tolerance and intolerance by the government, the Revenue authorities, the courts and the general population of tax-avoidance planning. The fact that we are in a phase of extreme intolerance in the current cycle does not mean that advice given in an earlier phase was incorrect or negligent. Many advisers were highly responsible in the advice they gave on such schemes and were scrupulous in their presentation of the risks and rewards of tax-planning schemes and of their possible outcomes to the client.

That was not, however, always the case. Having ourselves designed and implemented marketed tax-planning schemes in the past, my organisation now finds itself advising in respect of the management of HMRC's enquiries into schemes implemented on the advice of others and on the resulting litigation. Our experience suggests that there were a number of promoters of, and advisers on, such schemes whose advice fell below acceptable professional standards.

So, some taxpayers who implemented such schemes in good faith will be contemplating litigation against their advisers. Many of the questions involved will concern what a reasonable adviser would have done and advised at the time concerned. The consideration of that issue will require the input of an expert to assess the advice and actions of the adviser so as to allow the litigating solicitor to assess the validity of a claim and, in due course, for the expert, if it is appropriate, to give evidence in the proceedings.

Responsible advisers will not be immune from claims, but such claims are likely to be unsuccessful. Less responsible advisers may find themselves having some rather uncomfortable conversations with their professional indemnity insurers. ■

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