What duty is it anyway?

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Tax avoidance schemes and the duty to warn

The Court of Appeal has found against a firm of solicitors that advised on a tax avoidance scheme. In a useful judgment summarising when a duty to warn arises, the Court of Appeal overturned the High Court's decision and raised doubts over the applicable test when considering whether or not financial advisers have been negligent in advising on the risks associated with investments.

Background facts

A firm of solicitors advised on an employee benefit trust (EBT) structure designed to avoid both capital gains tax and inheritance tax. The scheme involved the transfer of company shares by way of a gift into the EBT and the creation of a sub-trust of which the beneficiaries were the family of the shareholder/transferor (the claimant). The relevant legislation prevented the application of advantageous tax treatment where beneficiaries of the trust were connected to shareholders of the company, as they were in this case. As such, the beneficiaries were excluded from receiving any benefits until after the death of the claimant (the so-called "post death exclusion"). In this way, the solicitors advised, on the death of the claimant and his wife, their remoter issue could receive benefits from the EBT free from both capital gains and inheritance tax.

After the EBT was put in place, a number of other advisers were involved in relation to the claimant's tax affairs and the EBT structure. At no point did any of these other advisers raise the possibility that there was a risk the EBT would fail and tax fall due.

HMRC opened investigations into the EBT in August 2005. One of the bases of HMRC's challenge was that the post death exclusion did not prevent the claimant or any person connected with him from benefitting from the trust's assets. The claimant instructed Leading tax Counsel, who had previously considered the structure, and who expressly disagreed with HMRC's arguments. Separate counsel was then instructed to consider the trust aspects of the structure and he advised that there were strong arguments that HMRC's arguments were correct. Leading tax Counsel subsequently accepted that HMRC's position was strong. The claimant settled with HMRC for nearly £11.3m and issued proceedings against his solicitors.

Any comments or queries?

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The High Court's decision

The High Court found that the solicitors should have made it clear that there was a possibility that the scheme would be challenged by HMRC and so the firm had acted in breach of their duty to the claimant. However, such a general health warning would not have deterred the claimant from going ahead with the scheme – only if a specific warning had been provided would the claimant have decided against executing the scheme. Further, this was not a case where a specific warning should have been given. The High Court referred to the involvement of other professionals and said: "a series of experienced tax specialists for several years did not interpret the provision [on the basis tax would fall due] or even suggest that it was arguable. In my judgment, therefore, this was not a case where it can be said that any competent and careful solicitor (of appropriate expertise) would have given the high level warning urged on behalf of [the claimant]".

The issue before the Court of Appeal

The issue before the Court of Appeal was whether no reasonably competent solicitor in the position of the defendant firm would have failed to give a specific warning that there was a significant risk that the scheme would fail to be effective for tax given the risk that the post death exclusion may not work. Notably the advice provided was not criticised as having been negligent – the issue was whether a specific warning should have been given.

In particular the claimant argued that the High Court was wrong (1) to conclude that the defendant firm did not act in breach of duty by failing to give a specific warning and (2) to take into account that other advisers failed to point out the existence of the interpretation argument raised by HMRC on the post death exclusion.

The Court of Appeal's findings

The Court of Appeal overturned the findings of the High Court. In doing so, the Court of Appeal looked first at the relevant statutory provisions which were at the centre of the interpretation arguments over the post death exclusion. The Court of Appeal found that HMRC's construction was more likely than not to be correct.

The Court of Appeal then noted that the relevant standard of care was agreed between the parties – namely, that of the reasonably competent practitioner in the field in question with the expertise claimed by the defendant. However, the parties differed as to how the Court of Appeal should assess that standard. The defendant argued that this should be by reference to whether the defendant acted in accordance with the practice of a body of competent respected professional opinion.

The claimant argued that: there was no need to take account of an actual body of professional opinion when determining whether the standard of care was breached and instead this was a matter for the court to determine; and, in any event, the High Court's approach of looking at what was advised by other advisers in this case was not itself a representative body.

The Court of Appeal agreed with the claimant and set out the following governing principles:

- the test as to whether or not there was a duty to warn requires a court to consider what advice ought to have been given in particular factual circumstances at the time. This substantively turns on (1) the view of the provision on which the issue turns and (2) whether the contrary arguments as to construction are of sufficient significance to require specific mention when taken with the degree of risk inherent in the circumstances and the importance in those circumstances of a balanced view of the provision. This is highly fact sensitive
- if the construction of the provision is clear, it is very likely that whatever the circumstances, the threshold of significant risk will not be met and it will not be necessary to caveat the advice given and explain the risks involved

- it is possible to be correct about the construction of a provision, or at least not negligent, but still be under a duty to point out the risks involved and to have been negligent in not having done so
- it is more likely that there will be a duty to point out the risks if litigation is already on foot or the point has already been taken, although this need not necessarily be the case
- the issue is not one of percentages or whether opposing possible constructions are “finely balanced” but is more nuanced.

The Court of Appeal went on to find that a specific warning should have been provided in the claimant’s case, relying on the following factors: this was an aggressive tax scheme marketed on the very basis that the claimant’s family would benefit from the assets within the EBT on his death free of tax, the potential tax charge was very large and the defendant’s fee was in the region of £2.4m. The position taken by other advisers at the time was irrelevant.

On the basis a specific warning should have been given, the claimant would not have executed the scheme and the solicitors were responsible for the losses of the EBT.

What about the duty to warn and other professionals?

One of the issues before the Court of Appeal was whether or not to adopt the alternative approach taken by the High Court in *Coutts v O’Hare* [2016] and the Supreme Court in *Montgomery v Lanarkshire Health Board* [2015] when considering the duty to warn. This alternative approach focusses on whether or not the professional has taken reasonable care to ensure that any material risks involved in, and any alternatives to, a proposed course of action were fully explained to and understood by the claimant. The materiality of risks is to be tested by reference to whether a reasonable person in the claimant’s position would attach significance to the risk or the professional was or should be aware that the claimant would attach significance to that risk.

This is a different test to the well-known *Bolam* test, which looks at whether or not a professional has discharged their duty of care by taking into account whether not the professional conformed with a standard tested by reference to a reasonable body of professional opinion. The alternative test is also different to that applied by the Court of Appeal which looked at whether there was a significant risk.

The Court of Appeal distinguished the Supreme Court’s decision in *Montgomery* with the case before it, on the basis that *Montgomery* was one where the Supreme Court was considering the duty to take reasonable care to ensure that the patient was aware of any material risks involved in any recommended treatment. This was a separate issue to the duty to diagnose and treat the patient which were questions of medical knowledge and expertise and subject to the *Bolam* test.

However, when it came to the High Court’s decision in *O’Hare*, the Court of Appeal side-stepped the issue and said “it is not necessary for me to decide whether the *Bolam* test is applicable in the case of financial advisers in circumstances such as those considered in *Coutts*”. This obiter comment casts doubts on whether the alternative approach adopted by the Supreme Court in *Montgomery* and applied by the High Court in *Coutts*, applies outside the doctor patient relationship.

Ultimately, the Court of Appeal’s judgment in this case was very much based upon the factual situation they held to have existed, namely that the defendant advised on a “very aggressive tax avoidance scheme” designed to avoid tax in a way that “might appear on the face of it to be too good to be true” and for which it charged £2.4m in fees. The clear undertone of the judgment is that in such circumstances there was always going to have been a clear duty to warn, probably in some detail, on all the specific ways in which the scheme might fail.

The relevance of the fee charged

The Court of Appeal appears to have been influenced in its judgment by the fees charged by the defendant in the region of £2.4m. This can be contrasted with the High Court's approach in *Bank of Ireland v Watts* [2017] where the modest fee charged of £1,500 by a quantity surveyor to produce an Initial Appraisal Report was considered "good evidence" of the limited nature of the service which the professional was expected to provide.

Where does this leave the law?

The Court of Appeal's decision arguably leaves the law in a state of flux, however, it appears to broadly be the case that:

1. in the context of professionals involved with interpreting legislation and legal documentation such as agreements, whether a duty to warn arises will depend upon the significance of the risk tested by reference to the legal interpretation of the provision and the wider factual circumstances. The greater the risk the more likely a warning should be given. The issue can be determined by the court without expert evidence
2. if the duty to warn depends on a professional opinion, such as a duty to warn of material risks in any recommended treatment in the medical context, then the issue is one of materiality. Expert evidence may be needed in order for the court to ascertain what risks might exist – but the question of the materiality of any risk is to be assessed against what a reasonable person in the claimant's position might perceive as material, which again does not require expert input
3. where the issue is one of advice – whether the advice provided is itself negligent in the first place – then the Bolam test applies.

The duty to warn when it comes to investment risk either falls within (2) or (3) above – where it falls following the Court of Appeal's judgment appears to be up for grabs.

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