What price advice?

How much reliance can you place on your tax adviser, asks Mala Kapacee

Reliance on an accountant or tax adviser is a controversial topic, particularly in relation to tax avoidance arrangements and where a client is issued with penalties for inaccurate return. Taxpayers invariably believe that appointing an adviser is sufficient for asserting they had taken reasonable care. Indeed, many business owners see this as a way of 'outsourcing' the work, perhaps not realising that this is not the same as outsourcing the responsibility for correct tax returns.

Those who used tax avoidance arrangements will have in the vast majority of case relied on opinions provided by Barristers and will be wondering if that can be used as a defence against penalties.

David McClean & Ors v Andrew Thornhill QC

Earlier this year, Andrew Thornhill QC was sued by the users of tax avoidance schemes on the basis that he had reviewed various tax avoidance arrangements and stated they would confer a tax advantage because the entities within the arrangements would be carrying on a trade on a commercial basis and with a view to profit. HMRC has now refused the tax reliefs and offered a settlement to users of the arrangements on this basis.

The court reviewing the case stated that Mr Thornhill "did not owe any duty of care to the schemes' investors"[1]. The full decision can be read here.

The basis of the decision was that Mr Thornhill was instructed by Scotts, promoters of the schemes, to advise on the tax implications of the arrangements. He was never instructed by any of the claimants and in signing the agreement to invest, the taxpayers had also confirmed that "*it was, and is, my responsibility to obtain appropriate advice, recommendations and assessment, as referred to above, from an independent financial adviser or other suitably qualified person".* This means that the investors who relied on Mr Thornhill's analysis on the basis that he was Scotts' adviser are now realising almost 20 years on that they were not entitled to do so.

One of the points the judge made was that the investors were business people and they had a certain level of knowledge in relation to finance and tax. They were not solely reliant on the advice from Mr Thornhill. We cannot say whether the judge's decision would have been different had the investors been (for example) laypeople or whether this was simply mentioned to support his decision.

The result unfortunately supports HMRC's case that taxpayers cannot be said to have taken reasonable care if they didn't take separate advice, addressed directly to the taxpayer and which was specific to the taxpayer's own affairs. Unfortunately, this also raises the question of when taxpayers should be aware of when the advice or opinion they are relying on is or is not sufficient. This is ironic considering people tend to rely on advice from a professional when they are not sure what the position is in the first place! How one is meant to identify – based on little to no understanding of the issues at hand – whether the advice is correct or dependable is confusing at best.

Implications of not taking separate advice

If tax avoidance arrangements are found not to work, not only are the investors required to pay taxes found to be due, but there is also the potential for penalties to apply.

[1] https://www.step.org/industry-news/england-and-wales-scheme-promoters-tax-advisor-not-liable-investors-their-losses

Penalties for inaccuracies in a tax return are legislated for in Schedule 24, Finance Act 2007. Penalties are a standard amount within certain threshold depending on whether a taxpayer was careless or deliberately filed an incorrect return. Where a taxpayer took reasonable care, penalties are £nil. Until Finance No.2 Act 2017, "reasonable care" included taking advice from a tax professional. The new legislation amended this so that reliance on an adviser or reliance on advice is not counted as a "reasonable excuse" if the advice is "disqualified" or is "provided by a certain interested person" (Sch 24, FA 2007). The decision for Mr Thornhill effectively supports HMRC's implementation of these penalties and the department's interpretation of whether sufficient advice was taken.

An "interested person" is defined for the purposes of Sch 24, FA 2007 as

- a person, other than P, who participated in the avoidance arrangements, or
- a person who for any consideration (whether or not in money) facilitated P's entering into the avoidance arrangements.

Advice is "disqualified" if any of the following applies:

- the advice was given...by an interested person;
- the advice was given...as a result of arrangements made between an interested person and the person who gave the advice;
- the person who gave the advice did not have appropriate expertise for giving the advice;
- the advice took no account of [the taxpayer]'s individual circumstances;
- the advice was addressed to, or given to, a person other than [the taxpayer].

Unfortunately, the legislation applies at the time penalties are considered, rather than looking at the applicable legislation at the time the arrangements were entered into (i.e. the time that the advice was taken/given). HMRC are applying penalties for inaccurate returns on this basis and clients should be made aware of the potential impact on their total liability.

Aside from aggressive tax avoidance cases, we come across a significant number of individuals who have instructed accountants and are confused why this alone does mean they have taken reasonable care. Reasonable care is a concept that goes through the courts relatively frequently and we discuss a few of the more recent cases below.

La Luz Residential Home Ltd & Ors v HMRC [2022] UKFTT 100 (TC)

This was an appeal against penalties on the basis of reasonable case. HMRC had opened investigations into a number of company and personal tax returns in relation to expenditure on a personally held property paid for by the company, whether dividends had been declared to directors or other individuals and other more minor points.

HMRC charged deliberate or deliberate and concealed penalties and the decision was upheld. The appellants claimed that they had relied on their accountant and the accountant confirmed he had made a number of errors. The Tribunal confirmed their view that although the taxpayer's accountant had made a number of errors, "failure to actively engage with his responsibilities as a director of a limited company and his blind and unequivocal reliance on his accountants was reckless". The Tribunal were unable to find any authority confirming that reckless behaviour could be equated to deliberate in relation to penalties for inaccurate returns.

Further, the FTT confirmed that "Becoming a director of a limited company brings with it a range of fiduciary duties which it is important to understand. Those fiduciary duties are part of what underpin the benefits of corporate status. [The taxpayer] made no effort to understand what incorporation meant for the business or for him. Significant and material errors were made in the accounts and the letters of representation he signed and for which, as a matter of law, he is responsible."

This is a clear statement from the Tribunal that where companies incur penalties for deliberate behaviour, reliance on an accountant is not enough. However the Tribunal did also say that "at least in the circumstances of this case...[the company should]... be held liable for the failures of its accountant", implying that each case will turn on its own merits as we will demonstrate with discussion of further cases below.

Interestingly, the Tribunal also suggested that "it is right that [the company]… if appropriate, take action against [the accountant]"

JT Quinns Limited & Queen-Rose Green v HMRC [2021] TC08338

HMRC opened enquiries into the company's tax return and again, errors included expenses claimed incorrectly for personal expenditure. On the personal side, the issues included undeclared rental income.

During the course of the investigation, HMRC requested information and when it was not provided issued the requests again under their formal powers (Sch 36). When the information was still not provided, HMRC applied penalties.

HMRC eventually raised assessments and penalties, for both the company and the individual.

The taxpayer appealed against the assessments and penalties, asserting complete reliance on accountant and that she had no knowledge of tax. She represented herself.

The FTT confirmed the tax amounts were valid but reduced the penalties from deliberate to careless. On reviewing the evidence, the FTT said they found Queen-Rose Green "to be evasive, unreliable and inconsistent" citing instances where the witness evidence provided was contradicted by statements later in the same hearing.

Importantly, the Tribunal "did not feel confident that the Second Appellant had any meaningful grasp over the details of her financial and tax affairs" and that "[the taxpayer]'s ignorance of the basic principles of finance and tax and reliance on the...accountant mean that the relevant inaccuracies cannot be seen as deliberate." Further, "her understanding of the relevant principles of finance and tax was so hazy and her reliance on the Appellants' accountant was so absolute that it would be quite wrong to conclude that she was aware of the inaccuracies in the Appellants' tax returns. That being the case, the inaccuracies cannot in our view be seen as being deliberate."

In our opinion, this conclusion may have been different if the judges had been less forgiving. Using the example of La Luz residential, it is plausible that different judges may suggest that being a Director of a company comes with fiduciary duties and a requirement to ensure the company's financial affairs are taken care of.

The key to the success of this appeal is the credibility of the taxpayer's lack of understanding. The Tribunal noted that "even now, [Queen-Rose Green] does not accept that many of the entries in the... tax returns were in fact inaccurate". In short, if a taxpayer is going to put forward the argument off complete reliance on the taxpayer, they will need to demonstrate their lack of understanding.

Finally, it is worth bearing in mind that reasonable care is a subjective test. The Tribunal in Auxilum [2016] UKFTT (TC05024) stated that "whether a reasonable taxpayer might have made the same error or even whether this taxpayer failed to take all reasonable steps to ensure that the return was accurate. It is a question of the knowledge and intention of the particular taxpayer at the time" and the FTT in this case confirmed this is the correct approach.

Stokes v HMRC TC07836

In this case, taxpayers filing tax returns to report their rental income received late filing penalties. They sent the required information to their accountant in June 2019 after daily penalties had accrued. The evidence was that normally the accountant would prepare and submit the returns in approximately one

week but this time, the returns were not filed until mid August 2019. The due date was 31 January 2019. The taxpayers appealed against the penalties on the basis that they had relied on their accountant to remind them to provide information and that the returns were filed late due to their accountant's father's death and associated concerns.

The appeal was upheld on the basis that the clients had provided the information to the accountant and then continued to chase him to prepare and submit the returns. The Tribunal allowed the appeal in relation to penalties incurred from the period of a few weeks after the taxpayers had sent the information to the accountant.

Even in this case, simply having an accountant was insufficient. The Tribunal also stated that the taxpayers should have made themselves aware of the tax return deadline and provided the information earlier rather than expecting the accountant to remind them. This is a clear guideline of what Tribunals might expect from a taxpayer with relatively simple affairs.

Key points

Overall HMRC and the Courts both take the view that ensuring tax returns are correct are the taxpayer's responsibility as far their expertise allows. The Courts take each case on its own merits and look at each taxpayer subjectively. As shown from the above, two taxpayers in similar situations (both directors of companies, with errors in the company and personal returns) can have very different outcomes at Tribunal.

In our opinion, this will depend largely on their credibility as witnesses and also how sympathetic the judges may be on that day. The similarities are that HMRC applied deliberate penalties to both, regardless of the circumstances, suggesting that the department has little sympathy and will seek to apply as high a penalty as possible.

Directors of a company are likely to be held to a generally higher bar when it comes to reasonable care, as compared to a newly self-employed tradesperson (for example). Tribunals are likely to consider that taxpayers who have been routinely required to file tax returns (i.e. have some experience of the system) should be aware of the deadlines and should be taking a proactive approach to their tax affairs. Easier said than done in many cases.

Sch 24, FA 2007 contains provisions whereby if a taxpayer places reliance on a third party and the third party is careless, then the penalties still apply. However, if an inaccurate return is filed through a careless or deliberate mistake by an agent but the taxpayer has done everything in their power to ensure the return was correct, then the taxpayer should not be help responsible. Therefore, the accountant confirming they had made an error was not in itself enough to confirm the taxpayer had taken reasonable care.

In relation to investigations where HMRC are asserting deliberate or careless behaviour, reliance on an adviser is unlikely to bring the penalties to a "reasonable care" level. Even as in J T Quinns Ltd and Queen-Rose Green v HMRC, where the Tribunal were satisfied that the taxpayer had no clue about taxation, the penalties were only brought down to "careless" (and time limits for assessments adjusted accordingly).

The fact that an accountant admits to errors even if only in an effort to help reduce the penalties could leave them open to a professional negligence claim should the appeal fail. As advisers, it might be worth considering from the start (perhaps add it to the KYC questions) how sophisticated the client is and considering whether additional work should be carried out while preparing the tax returns. Documenting things like conversations discussing the client's level of sophistication, whether they agree to the additional work being carried out and adding a paragraph to covering letters explaining that the responsibility is theirs may be helpful in the event of professional negligence claims.

If nothing else, requesting a positive confirmation of the latter might focus the client a little on understanding where the responsibility for correct tax returns lies.

For structures that were implemented in the past, clients should remember that advice is only valid if it is current and takes into account their specific circumstances. They are advised therefore to routinely (we suggest annually, especially for more complex planning) request a review of previous advice, from an independent adviser, to confirm that the advice is valid and/or that the structure in place still produces the expected result. The review should be undertaken bearing in mind any legislation changes since the advice was first provided, together with a consideration of changes in best practice and HMRC approach.

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