Considering all outcomes

Management of taxes   Professional standards

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Harriet Brown considers what we can learn from the *Baxendale Walker* case on professional negligence

Key Points

What is the issue?

Mr Barker's case was that a reasonably careful practitioner with the degree of expertise claimed by Mr Baxendale Walker should have warned Mr Barker that there was a significant risk that the EBT would fail to deliver the anticipated tax advantages because it did not exclude his family members as beneficiaries after his death. The High Court had found that Mr Baxendale Walker had not been negligent. The Court of Appeal took the opposite view.

What does it mean to me?

In a tax context *Barker* is an important case: it provides us with a clear indication of how section 28(4) should be applied. However, it also tells us (and reminds us) about how we should advise.

What can I take away?

Tax advisers should take note of the decision in *Barker* and satisfy themselves that their advice, particularly where it is in relation to artificial or aggressive tax avoidance, meets the correct standards.

Barker v Baxendale Walker ([2017] EWCA Civ 2056)

This was a civil case against the well-known tax adviser, Paul Baxendale Walker, in relation to certain employee benefit trusts that were intended to provide capital gains and inheritance tax advantages.

One aim was for the EBT to come within Inheritance Tax Act 1984 (‘IHTA’), section 28 which, broadly, provides a transfer of shares by an individual will be exempt to the extent that the value transferred is attributable to shares which become comprised in a settlement that is, broadly, an employee benefit trust.

This case turned upon whether or not the category of beneficiaries of the trust in question precluded the exemption from applying. In 1998, Mr Barker (‘B’) was advised by Baxendale Walker solicitors (‘BW’), to transfer shares in his company to which he was beneficially entitled into an employee benefit trust (‘EBT’).

The EBT provided that, after the deaths of B and his wife, trust monies could be applied for the benefit of B’s children. B’s aim was that his shares would pass to his children unburdened by inheritance or capital gains tax.

B’s case was that a reasonably careful practitioner with the degree of expertise claimed by BW should have warned B that there was a significant risk that the EBT would fail to deliver the anticipated tax advantages because it did not exclude his family members as beneficiaries after his death.

Legislation: why did the family members matter?

IHTA, section 28 provides (so far as is relevant):

1. A transfer of value made by an individual who is beneficially entitled to shares in a company is an exempt transfer to the extent that the value transferred is attributable to shares in or securities of the company which become comprised in a settlement if –
   (a) the trusts of the settlement are of the description specified in section 86(1) below, and
   (b) the persons for whose benefit the trusts permit the settled property to be applied include all or most of the persons employed by or holding office with the company.
2. Subsection (1) above shall not apply if the trusts permit any of the settled property to be applied at any time … for the benefit of –
   (a) a person who is a participator in the company mentioned in subsection (1) above; or
   (d) any person who is connected with any person within paragraph (a), (b) or (c) above.

Thus from this it can be seen that participators, and those connected with them could not be beneficiaries of the EBT if transfers were to be exempt. The issue in question was that the children of B would, potentially be connected with him pursuant to IHTA, section 270 and the Taxation of Chargeable Gains Act 1990 (‘TCGA’), section 286. Under these provisions individuals are connected if they are relatives (TCGA, section 286). ‘Relative’ includes lineal descendant (TCGA, section 286(8)).

The parties’ arguments

The arguments turned on a perceived ambiguity in the time at which the restrictions in IHTA, section 28 applied. This is the restriction in section 28(4), which says that the exemption will not apply where a participator or ‘connection’ of the participator can benefit. The ambiguity arises because of the wording, which provides ‘… if the trusts permit any of the settled property to be applied at any time … for the benefit of … a person who is a participator … or … any person who is connected with any person within paragraph (a)’.

The argument for B was that:

- the requirements of section 28(1)(a) have to be met at the date of transfer of value and that the criteria in section 28(4) should be evaluated at that time;
- sections 28(4)(a), (b) and (d) each prohibit the trust from benefitting a person who ‘is’ within the prohibited category, and the use of the present tense ‘is’ indicates that whether the test for prohibition is met at the date of the transfer is the relevant test – such approach giving effect to the requirement that the prohibition must apply at ‘any time’; and
- the fact that they may not be ‘connected persons’ in the future is irrelevant if they are at the time of transfer.

On behalf of BW it was argued that:

- while it was accepted that the question of whether section 28 was satisfied must be considered at the outset when the transfer of value is made, the prohibitions in section 28(4)(a) – (d) need only be avoided at the date that the person in question has a benefit applied to him or her from the trust;
- this is because of the use of ‘is’ in section 28(4)(a) and (d) (the language here was contrasted with ‘has been’ in section 28(4)(c));
- the phrase ‘at any time’ is not within paragraph (a) itself; and
- consequently, someone who is initially in a prohibited category may benefit at a later date, if they have ceased to be within that category, i.e. despite the fact that B’s family would fall within section 28(4)(d) at the date on which the shares were transferred to the EBT, they would no longer be ‘connected’ with a ‘participator’ (B) after his death and therefore, could benefit at that stage without falling within the prohibition.

The decision on construction

The Court of Appeal’s decision on construction, which – after all – was merely a stepping stone on the way to a decision on liability, was briefly given. In essence the construction given on behalf of B was adopted. This was because BW’s construction:

- required a great deal of implication, far beyond that required by B’s approach;
- gave little or no weight to the words ‘at any time’; and
- created ambiguity as to the meaning of ‘applied’.

In making its decision the Court of Appeal merely said '… *Mr Baxendale-Walker's construction of section 28(4) is very unlikely to be correct* …' and by doing so did not decide definitively how IHTA, section 28(4) should be applied. This statement is, however, part of the 'ratio' of the decision and, therefore, should be binding on lower courts, including the tax tribunals.

On that basis what appears to have been decided is that the proper construction is likely to be B's, but there remains a small doubt.

Consequently, while this was a case about professional negligence – and of itself tells us some potentially important things about how we should advise – it is also an important decision on the proper interpretation of IHTA, section 28. In future it will be necessary to consider this decision when applying section 28. This is particularly in the context of the various EBTs that are likely to be similar, and which were heavily marketed in the past.

The decision on negligence

The High Court had found that BW had not been negligent. The Court of Appeal took the opposite view. In the High Court B had accepted that a reasonable and competent solicitor could have concluded that BW's construction was correct but argued that there was a '*significant risk*' that the construction put forward for B was the better one.

The High Court held that a general 'health warning' about the EBT being a tax scheme that HMRC would challenge should have been given (though B accepted that he would have gone ahead in the face of such warning). It further held B's interpretation was not a probable one and, therefore, since in the High Court's view the construction given by BW was likely to be correct, he probably had no duty to warn that his interpretation could be wrong unless the arguments were finely balanced (which the High Court did not feel was the case here).

B's case in the Court of Appeal was that he had been entitled to an additional specific warning of a significant risk. The Court of Appeal held:

- whether a solicitor is bound to warn of a significant risk that he might be wrong is heavily fact sensitive;
- even where the solicitor is likely to be correct, it does not necessarily follow that there will be no such duty unless the arguments are finely balanced;
- BW did – on the facts of B's case – owe a duty to give a specific warning to the Claimant; and
- in this case the reasons such a specific duty was owed were (i) the probable correct construction of section 28(4); (ii) the aggressive nature of the tax avoidance scheme; and (iii) the high value of the shares B was proposing to transfer.

What have we learnt from *Barker*?

In a tax context *Barker* is an important case: it provides us with a clear indication of how section 28(4) should be applied. However, it also tells us (and reminds us) about how we should advise. It is not new law that in certain circumstances solicitors (and other professional advisers) will have a duty to advise their clients of a significant risk that their analysis is wrong. In cases like this one, where there is aggressive avoidance, it should be noted that the PCRT provides additional obligations, which may not be relevant to determining negligence, but compliance with which is essential in order to comply with professional standards established by CIOT.

However, what may have long been suspected but which may not have been so clearly articulated by the courts previously is that, particularly in the context of aggressive avoidance schemes, reasonable, competent tax advisers should be aware that the courts are reluctant to allow unusual steps included merely to frustrate the purpose of tax legislation, to achieve their aim. This requires tax advisers to consider realistically the likely outcome of a legislative interpretation that results in such frustration, and to give similarly realistic consideration to alternative but reasonable constructions that result in an outcome that is in line with the statutory purpose.

Tax advisers should take note of the decision in *Barker* and satisfy themselves that their advice, particularly where it is in relation to artificial or aggressive tax avoidance, meets this standard. Those who advised on such schemes more extensively in the past may wish to revisit such advice to determine if it is likely to give rise to a liability on this basis. In addition, when after the effective date (1 March 2017) tax advisers should also ensure that they comply with the relevant standard in the PCRT, paying particular reference to paragraphs 2.28 et seq.