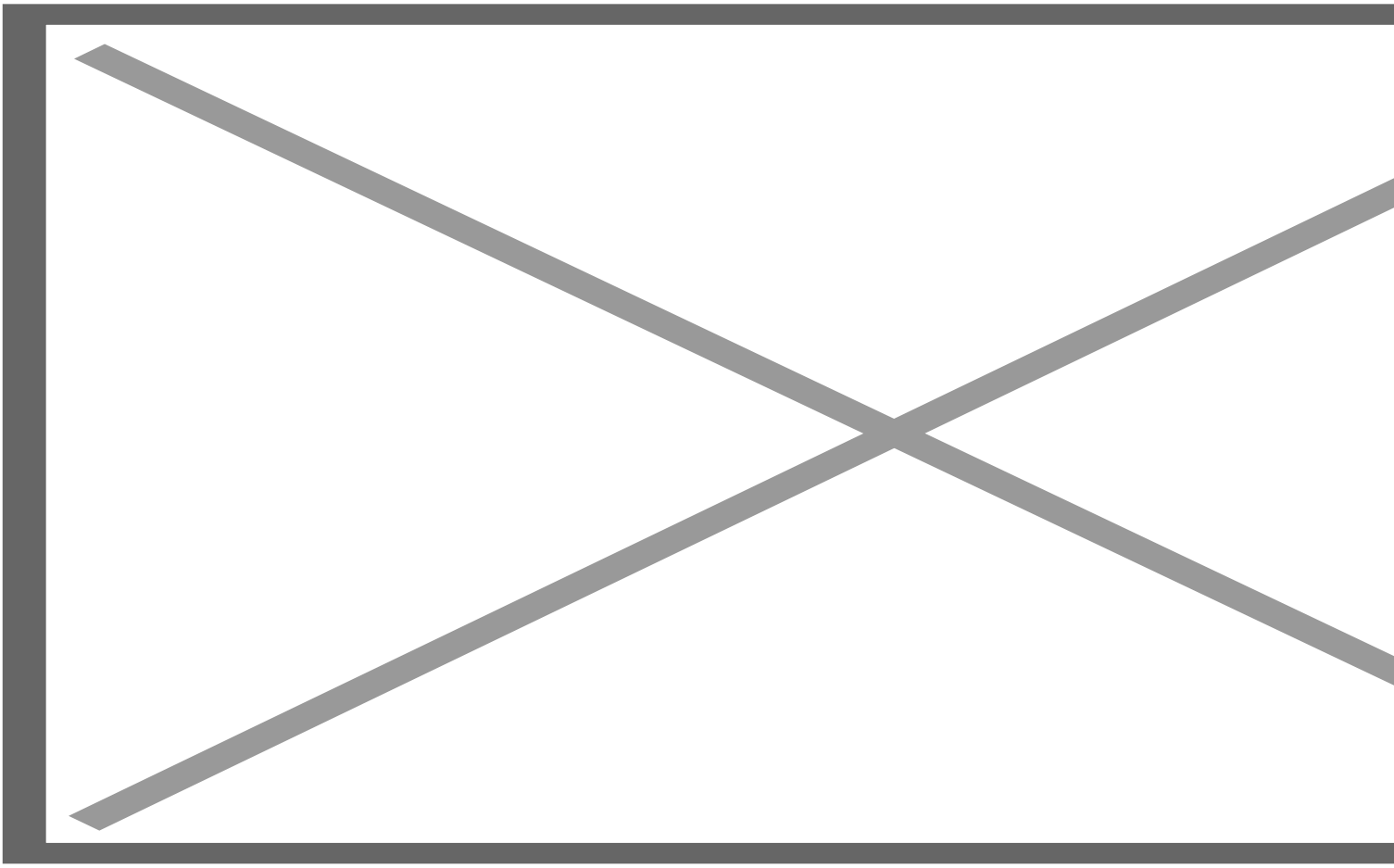
Masters of disguise unmasked

Employment Tax | Management of taxes



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Patrick Cannon and *Simon Farrell QC* examine what remedies users of Disguised Remuneration arrangements may have against the advisers and IFAs who recommended they enter into the arrangements

Key Points

What is the issue?

Users of failed DR arrangements may have a legal claim against their advisers.

What does it mean to me?

Users who are settling their arrangements with HMRC should take advice to see what they could claim back from their advisers and professional insurers.

What can I take away?

The usual problem of proving a loss with a failed tax scheme may not apply here. However users should get their skates on with issuing a claim to avoid the expiry of the limitation period for negligence claims.

The tide has undoubtedly gone out so far as such arrangements are concerned. HMRC are highly active in denying claimed relief and in the worst examples are pursuing criminal cases against both the financial advisers who recommended them and those who sought tax relief. In truth most of those who entered exotic tax saving arrangements did so because they were told and accepted in good faith that such schemes were lawful. Many are now facing financial disaster but will have potential claims against those who miss-sold them the tax schemes in the first place.

The game is up

Those who devised and sold DR arrangements had one hell of a ride between the early noughties and the Supreme Court's decision in Rangers [2017]. Enormous amounts of fees were earned devising, selling and distributing these schemes to lay clients through IFAs and networks of accountants. As is now well known these schemes have now been comprehensively defeated by HMRC through the courts and to underline this victory the GAAR Advisory Panel has recently issued opinions on certain types of the schemes holding that the entry into and carrying out of them was not a reasonable course of action.

Much misery has been caused to users of these failed schemes with life-changing settlement sums being demanded and obtained by HMRC through their various settlement opportunities, the latest of which was examined by Helen Adams and Sarah Stenton in the April issue of this journal. Family homes are being re-mortgaged or sold, children removed from private schools, savings and pensions earmarked for a comfortable retirement plundered, not to mention the enormous stress and resulting distressing medical conditions that have resulted. This comes at a time when the businesses owned by the users are struggling and the earning capacity of users has drastically reduced for age related and other reasons. Assets purchased with the tax saved may also have lost value. In addition HMRC have successfully prosecuted promoters, financial advisers and even participants in tax schemes in the criminal courts, many of whom have been sent to prison and have been the subject of confiscation orders with terms of further imprisonment in default.

Much energy and time is currently being spent making the necessary arrangements to settle users' tax affairs with HMRC but as users begin to recover from the shock of the terrible predicament into which they have been placed with the arrival of Accelerated Payment Notices and HMRC's spreadsheets showing the PAYE, NIC, IHT, interest and County Court fees owing, thoughts are beginning to turn to the role of the people who pushed these schemes.

What were they thinking?

It was quite clear that by 9 December, 2010 when HM Treasury published its statement 'Anti-Avoidance: Disguised Remuneration' that the Government was determined to attack DR arrangements and that by implication anyone who continued to pursue such arrangements was acting contrary to the purpose of the legislation and the intention of Parliament and would be subject to official scrutiny. The introduction of Part 7A into ITEPA 2003 from April 2011 to tackle schemes which avoided or deferred PAYE and NICs gave legislative effect to this intention. However those who had earned a lucrative living devising and selling these schemes were not willing to call it a day and decided to devise schemes of mind-boggling complexity and artificiality to try and defeat the legislation and will of Parliament. While these schemes have now been defeated both in the FTT and

the Courts the failure by HMRC to effectively tackle them for six years meant that users continued to be put into these schemes with assurances from leading tax counsel that they stood a reasonable chance of working. However anyone who devised or sold such schemes after 2010 should clearly have given a suitable risk warning to users.

The law

The Court of Appeal's decision in *Barker v Baxendale Walker* [2017] EWCA Civ 2056 held that someone advising on a tax avoidance scheme that was likely to be attacked by HMRC and receive judicial and other scrutiny should give the client a significant warning of this risk and provide the client with a balanced view identifying alternative interpretations and warning that their preferred interpretation may not prevail. The authors have seen no evidence that any 'significant risk' warnings were given and the 'warnings' as such were at a lower level and were to the effect that no guarantee was given that the schemes in question would work. In other words a negative rather than a positive warning was given and this does not come near to the high threshold set by *Baxendale Walker*. On this basis the advice was given negligently and the purported limitations of liability that were typically mentioned may not apply because those limitations were predicated on the advisers involved exercising reasonable care and skill. These were extremely aggressive tax avoidance schemes with a high level of artificiality and contrary to the purpose of the legislation and were always likely to be attacked by HMRC as indeed has now happened. The schemes were positively promoted to clients often by accountants who had a professional duty to give best advice to clients but who were conflicted by the commission they were paid by the wholesalers of these schemes.

In many cases there may therefore be a *prima facie* case for negligence in failing to give users a significant risk warning or a balanced view of the different possible interpretations of the tax consequences of these arrangements. However there are two necessary requirements that must be addressed before a user could seek legal redress against the adviser concerned. These are the measure of damages and the potential limitation period for starting legal action.

Measure of damages

The measure of loss in contract and in tort is expressed differently:

1. in contract, the measure of loss seeks to put the claimant in the position they would have been in had the contract been performed had there been no breach – i.e. had the tax planning worked; and
2. in tort, the measure of loss is expressed as an amount that will put the claimant in the position they would have been in had there been no negligence.

Often there will be no difference as, for example, where an accountant misses a filing deadline to claim a tax relief – the tax saving opportunity that has been missed is the measure of loss in contract and in tort.

However, the position is more complicated in relation to failed tax schemes. In *Grimm v Newman* [2002] STC 1388 CA, it was held that on the basis that where a tax scheme would not have worked and the claimant had failed to show that any other scheme would have worked, then he had suffered no loss.

Despite this, in the cases of failed DR arrangements the argument that users would have otherwise paid the tax they were advised could be avoided and so have suffered no loss can be countered by pointing to the tax saving available to users had they simply made ordinary tax allowable provisions such as pension contributions available to them in each relevant year. The allowable pension contributions in many of the years concerned were considerable and were officially encouraged. Moreover, the investment returns that would have been

accumulated in the ensuing years had those contributions been sensibly invested would have been considerable.

In cases seen by the authors the scheme providers went through a façade each year with each user by conducting a remuneration benefits survey canvassing various options for the director/shareholders only to conclude year after year that their scheme was the best option. The idea was to give commercial cover for the decision to enter the scheme. Tellingly the far more sensible option of making tax allowable pension contributions was side-lined in these reports with the comment that this required 'specialist advice'. This dismissal of the pensions route without further consideration in favour of a highly contrived and aggressive tax avoidance scheme is telling.

Also, any additional cost of involvement in the schemes ought, in principle, to be recoverable as well as the additional financial costs of the position users now find themselves in. There is some support for this in *Lagden v O'Connor* [2003] UKHL 64, [2004] 1 AC 1067, where the following passage from *Clippins Oil Co v Edinburgh and District Water Trustees* [1907] AC 291 at 303 was approved: '... the wrongdoer must take his victim *talem gualem* [as he finds him], and if the position of the latter is aggravated because he is without the means of mitigating it, so much the worse for the wrongdoer, who has got to be answerable for the consequences flowing from his tortuous act.'

And at [31] of *Lagden*: 'The principle which emerges from this passage is that it is not open to the wrongdoer to require the injured party to bear any part of the cost of obtaining such indemnification for his loss as will place him in the same position as he was before the accident.'

Limitation period

Proceedings for breach of contract must be issued within six years from the date of the breach which is the date on which the cause of action accrues. Proceedings for negligence must be issued six years from the date the cause of action accrued, and this is when the claimant suffered damage which can be later than the relevant date in contract. In cases of failed tax schemes the six year period is frequently exceeded before the failure of the scheme has even been determined by the Courts. HMRC tax enquiries themselves often take many years as do the subsequent FTT and Court proceedings.

Under the Limitation Act 1980 section 14A, the period for claiming in negligence is extended so that a claimant has either:

1. the six year period, or if it ends later
2. a period of three years from the 'starting date'.

The 'starting date' begins on the date that a claimant has both the 'knowledge required' and the right to bring an action. 'Knowledge' is actual or constructive knowledge of the material facts about the damage in respect of which damages are claimed and that the damage was attributable to the act or omission which is alleged to have been negligent. In *Perry v Moysey* [1998], it was held that the claimant had an arguable case under section 14A because he did not know until the demand for arrears of tax was received that the defendant had caused him any damage by his negligent tax advice.

Many of the failed DR arrangements now under enquiry were done in 2010/2011 and in the several years following and it may be thought that the six year time limit has begun to bite on the earlier schemes. However in many of those cases positive advice continued to be given by the scheme providers to the effect that the past schemes had good chances of success and that HMRC would not succeed in attacking them. On this basis users receiving such guidance would at that stage not have the 'knowledge required' to realise that there had been negligence and a likelihood that HMRC would defeat the scheme and so a claim to rely on section 14A could be

made out. On this basis, the ‘starting date’ might not begin until perhaps the Rangers decision of the Supreme Court in 2017. On this basis, users would have three years from then to start proceedings in respect of the post-2010 schemes. It is possible then that users of older schemes are still in time to commence proceedings.

Where to now?

Many users may now have good grounds to claim back monies now being paid to HMRC from the advisers who put them into these DR arrangements. The practicalities of pursuing such a claim need very careful thought including the costs of such an action if legal proceedings are started. After the event (or ATE) insurance may be available which would cover the risk of costs if the claim failed and in some cases no premium is payable up front although with an increased cost upon a successful outcome. Another factor is whether the person liable is still around and is worth suing. While most scheme providers either no longer exist or are mere shells these providers were middle-men and were backed by tax counsel and fronted by accountants and IFAs, many of whom are still operating and have professional insurance. It will be interesting to see what claims develop as the shock of having to settle with HMRC subsides or is normalised and thoughts turn to those really responsible.

Many clients are increasingly angry and that anger may lead to more than merely a civil claim as in appropriate cases injured parties would have the right to bring a private criminal case against those who dishonestly persuaded them to enter tax schemes. Potential offences include conspiracy to defraud and offences under sections 2 and 4 of the Fraud Act 2006. These latter offences are committed where a person either dishonestly with a view to make a gain or cause a loss makes a false representation to another or where they occupy a position of trust and dishonestly abuse it. A successful criminal case would have the consequence that the dishonest tax advisers would not only be sent to prison but would also be subject to confiscation and compensation orders. The costs of a private prosecution can be paid out of central funds. Such a course should only be adopted in clear cases.