Duties of Care to Third Parties in Tax Avoidance Schemes – Disappointment for Investors in McClean as Zacaroli, J Rejects Claims

Mr Justice Zacaroli has now handed down his judgment in David McClean and others v Andrew Thornhill QC, [2022] EWHC 457 (Ch) – a ~£40m claim by investors in a tax scheme against one of the leading tax barristers in the country. The judge dismissed the claim in its entirety holding, amongst other things that the barrister did not owe a duty of care to the investors.

The judgment is a welcome decision for legal and accounting professionals and their insurers and provides useful guidance on the potential duties of care to investors owed by professionals advising both sponsors of tax schemes and the vehicle through which the scheme is conducted. In addition, it provides essential guidance on the circumstances in which a duty to warn clients will form part of a professional's obligations.

Background

The claim relates to tax advice the barrister gave on a tax scheme involving a film distribution business. Three LLPs had been created for the purpose of participation in the distribution of films. These were marketed to investors on the basis that they would be entitled to tax relief against income or capital gains for trading losses that the LLPs were anticipated to make ("Schemes"). The Schemes did not work out as intended in that HMRC refused the reliefs claimed by the investors. The investors brought claims against the barrister alleging that he owed them a duty of care in tort and had been negligent.

The barrister had been engaged to provide advice on the tax consequences of the Schemes to its promoters (in the case of the first scheme) and to the promoters and the LLPs (in the case of

AUTHOR

Laura Stocks
Partner
+44 20 3060 6389
laura.stocks@rpc.co.uk

Nick Bird
Partner
+44 20 3060 6548
nick.bird@rpc.co.uk

Charlotte Thompson
Associate
+44 20 3060 6722
charlotte.thompson@rpc.co.uk

two subsequent ones). The barrister gave a number of opinions on the Schemes in the early 2000s (the "Opinions") as well as confirming to the promoters that an information memorandum ("IM") provided to investors was not inconsistent with his views. The barrister was not asked to advise any of the investors and none of the investors was his client. He did though consent both to being named as tax advisor to the promoters (and the LLPs in the case of the second and third schemes) in the IM and to the Opinions being made available to potential investors if they requested them.

The investors claimed that the barrister owed them a duty of care in respect of the advice he gave to the promoters. He had consented to this advice being made available to them and – so they said - relied on his advice when entering into the Schemes. They alleged that had the barrister not given such advice the Schemes would not have been promoted to them, or if they had, none of them would have invested.

The court's analysis of the alleged duty of care to a non-client

Mr Justice Zacaroli concluded that the barrister owed no duty of care to investors in respect of the advice he gave in relation to the Schemes. He began by noting the many factors which pointed towards a duty being owed. Those included that the barrister:

- was a person with special skill;
- gave his advice in the knowledge that it was to be made available to potential investors who asked for it;
- knew that the IM was a marketing document intended to attract investors to the Scheme;
- was aware that potential investors were likely to take comfort from the fact that he (i) was a leading expert in the field (ii) was named as tax adviser to the promotor (or the promotor and the LLP) and (iii) had given positive advice on the prospects of tax benefits being achieved;
- accepted that his advice would assist investors and in particular their IFAs to evaluate whether or not their clients should go into the arrangement; and
- knew his advice was on the very point of critical importance to any potential investor.

He went on to consider the wider factors and circumstances to assess whether in fact that starting point was displaced. He drew a distinction between two groups of investors.

The first group (in which the advice "crossed the line between the barrister and the claimant") comprised those who saw one of the barrister's Opinions, or whose advisor saw them or relied upon them in advising the investor. The second group comprised those who saw (or whose advisor saw) only the IM.

He concluded that the first group claimants could not reasonably be taken to rely on the barrister's advice without making their own independent inquiry. The IM advised investors to consult their own tax advisors on the Schemes, and no investor could subscribe to the LLP without first warranting that they had relied only on the advice of their own advisors (as per the wording of the subscription agreement entered into by investors). The barrister's own Opinions did not include express exclusions of liability but the Opinions were only available to investors by their reference in the IM and were only made available to investors on request.

The judge carried out a detailed analysis of the wording of the IM and warranties in the subscription agreement and rejected the claimants' submission that the disclaimer language referred to investors consulting their tax advisors on the Schemes' implications on their **personal** tax position as opposed to the effectiveness of the Schemes more generally.

Having reached that conclusion, he went on to consider whether those disclaimers were effective. He noted (per Lord Oliver in Caparo Industries PLC v Dickman [1990] 2 AC 605) that the disclaimer language of the IM and subscription agreement would not be effective if there was countervailing "actual or presumed knowledge" that the advice was likely to be relied upon without independent verification. However, he was satisfied that it would not have been reasonable for investors, in the face of the language of the IM and the subscription agreement, to rely upon the barrister's advice without independent inquiry, or that the barrister ought reasonably to have foreseen that they would do so. This was on based on a number of reasons including that:

- the Schemes were high enough in value for it to be reasonable to assume that the investors either had their own advisers, or were in a position to appoint them;
- the barrister was not retained as an adviser to the investors and any reasonable investor would have understood that where the IM advised them to consult their tax advisers, this was a reference to advisers other than the barrister;
- the promoters were selling and the investors were buying into the Schemes, so were on opposite sides of the transaction (despite an identity of interest); and perhaps most importantly
- the Schemes could only be marketed via independent professional advisers, meaning that all investors would have the benefit of an IFA to assist them, and accordingly it was reasonable for the barrister to expect that the significance of the recommendation for the investors to take advice would be highlighted by their IFA.

He concluded that it was objectively reasonable to assume that the investors would take independent professional advice. This was because they had been advised to do so and warranted that they had done so. The claimants put forward a number of arguments to displace this conclusion, including relying in particular on the status of the barrister as the leading tax silk in the country and the firmness of his advice in his Opinions but these were dismissed by the judge.

The second group comprised those investors did not call for the Opinions (whether by themselves or their IFAs). Mr Justice Zacaroli held that there could be no duty owed to these in addition because no advice from the barrister was ever communicated to them.

The judge did not decide the case by reference to the application of UCTA. He held (at paragraph 170)

> *"... the test for liability depends on whether it was reasonable for the claimant to have relied on what the representor (or adviser) said and whether the representor (or adviser) should reasonably have foreseen that they would do so, without independent inquiry. That is a question that has to be answered by reference to all the relevant circumstances...".*

Accordingly, the failure to establish a duty of care was an antecedent issue to the exclusion of liability by notice.

The claimants therefore failed to establish any duty of care owed to them by the barrister. In addition, the Court went on to consider breach, reliance and causation and limitation, but found that even had there been a duty in existence, there were other significant obstacles to the investors' case.

Alleged Breach of Duty of Care

The court also rejected the claimants' case on the existence of a breach of duty by the barrister. The judgment provides useful guidance on the extent to which a professional is expected to foresee all of the arguments that may be raised against the viability of the scheme by HMRC. The judge held that a competent tax barrister was not expected to anticipate all the possible approaches that HMRC might take. The position has to be assessed by reference to the state of the law and attitude of HMRC at the relevant time of the advice.

The claimants also pursed a claim of breach arising out of an alleged "duty to warn" of the risks. This led to an examination of the approach to that in Barker v Baxendale Walker Solicitors [2018] 1 WLR 1905. In that case the Court of Appeal confirmed that even where the advice given by a solicitor is found to be correct, she or he may still breach their duty if they fail to advise the client of the risk of a contrary interpretation or outcome.

The judge rejected the existence of any such duty in this case. He identified the fact that the test from Queen Elizabeth Grammar School Blackburn Ltd v Banks Wilson (A Firm) [2001] EWCA Civ 1360 showed that the existence of such a duty was highly fact sensitive and that it turned amongst other things on the degree of sophistication of the client. He held that the client for the purpose of this case was the promoter and that they

> *"... were themselves highly sophisticated and likely to have been fully aware from their experience in promoting tax avoidance schemes of the issues to which they gave rise ...".*

He went on to find that if there had been such a duty and if an appropriate warning had been given then the scheme would still have proceeded and the claimants would have made the same investments that they did. He provided a number of specific and generic reasons for this including the fact that the IM already contained a number of warnings which did not deter the investors.

Commentary

The judgment provides a clear path through the authorities on the assumption of a duty of care to non-clients and the conclusions will provide significant comfort to professional indemnity insurers and legal professionals.

Crucially, it considered the situation in which claimants have made statements of non-reliance in the transaction documents but nonetheless rely on **"... countervailing "actual or presumed knowledge" that the advice was in fact likely to be relied upon without independent verification ...**". This is a common feature of these types of investor claims.

The judgment is though highly fact sensitive and turns on the specific circumstances of the case. Amongst other things, the barrister was assisted by the wording in the IM and subscription agreement leading to the (objective) unreasonableness of an investors' reliance upon the Opinions. The court also gave significant weight to the fact that the investors could only access the investment via an IFA who, acting properly, ought to have given appropriate independent advice (or it could be reasonably expected that they would do so).

A key ground relied on by the claimants was the absence of any disclaimer in the Opinions and the voluntary agreement of the barrister for the Opinions to be made available to investors upon request. These are factors that advisors are likely to consider going forward in their risk assessments.

The case also provides useful guidance on the imposition of a duty of care to warn in circumstances where the claimants are third parties and the client is a sophisticated entity.

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