TAXING ISSUES
THE IMPACT OF THE THORNHILL CASE

1. The judgment of Zacaroli J in **McLean & others v Thornhill** [2022] EWHC 457 (Ch) contains a multitude of interesting points relevant not only to the potential liability of tax counsel opining on the efficacy of a tax scheme, but also to professional indemnity claims more generally.

2. This case note seeks to explain what the case decides and why it is of more general interest. It is right to emphasise at the outset that the Court robustly dismissed the claims against the Defendant.

The Facts

3. These claims were brought by a group of investors in certain film schemes, which were designed to enable the investors to claim reliefs in relation to income tax and capital gains tax liabilities.

4. The investors subscribed to the schemes (of which there were 3) between January 2003 and April 2004.

5. The Defendant, a very eminent and experienced tax silk, advised the "Sponsors" (vendors) of the schemes as to whether they would achieve their intended effect in terms of producing tax relief.

6. HMRC enquired into the schemes; rejected the claims for relief; and ultimately agreed settlement with the investors.

7. The Claimants then sued the Defendant, seeking to recover damages arising from their participation in the schemes.

The Issues

8. These were wide ranging but are conveniently summarised at §12 of the judgment.

9. The issues included the following:
   (1) Did the Defendant owe a duty of care to the Claimants?
   (2) Did he breach such duty as may have been owed, either in failing to give reasonable advice or failing to warn the Claimants of the risks to which they were exposed in the event that he was wrong?
   (3) Was UCTA 1977 engaged?
   (4) Were the claims time barred?

Duty of Care

10. The Claimants' somewhat surprising case was that the issue was concluded in their favour principally by recourse to the classic case of **Hedley Byrne v Heller** [1964] AC 465.

11. Zacaroli J took the view that the law had moved on somewhat since **Hedley Byrne**. He analysed the subsequent authorities from which he derived the following main conclusions:

    a. The two principal questions to be addressed when deciding whether a representor owes a duty of care in relation to a statement (or advice) given to a representee are:
       i. Was it reasonable for the representee to have relied on what was communicated to him by the representor; and

ii. Should the representor have reasonably anticipated that the representee would so rely?

b. The judge derived these two questions from the decision of the Supreme Court in **NRAM Ltd v Steel** [2018] 1 WLR 1190. See judgment at §71. He also held that the questions are to be answered by reference to an objective approach. See **BCCI v Price Waterhouse** [1998] BCC 617 (CA).

c. The judge applied certain observations of the Court of Appeal in the **BCCI** case as to the factors to be taken into account when answering these questions. These included:
   i. The nature of the relationship between the parties, and the fact that a duty will be easier to establish if the parties are, in respect of the relevant transaction, on "the same side of the fence" rather than dealing at arm's length;
   ii. The precise circumstances in which the statement was made or advice given, including the role of any relevant third party;
   iii. The precise circumstances of the communication, including whether it was made directly or via a third party, and for what purpose it was made;
   iv. The presence or absence of other parties who could give advice on the subject matter of the communication; and
   v. The opportunity for the representor to insert a disclaimer.

12. The judge pointed out that the Defendant had been retained to advise the Sponsors. The Sponsors were selling the scheme to the Claimants and were therefore on opposite sides of the transaction, not on the same side of the fence. The judge considered that this was very important and that the force of the point was not diluted by the fact that the Sponsors' interest was aligned with that of the Claimants, in so far as each wished the schemes to be successful in generating the tax advantage (§90).

13. Further, the Claimants had specifically warranted that they had taken their own advice. Provision of this warranty was a pre-condition to the Claimants' subscribing to the schemes. The Defendant was entitled to assume that such advice had been sought and given, which meant that it was not reasonable for him to think that his Opinions had been relied on rather than the independent advice which the Claimants had promised they had taken. The judge rejected a contention that because the Defendant was (arguably) the leading tax silk in the jurisdiction, there was no point in having his advice "checked" by anyone else (§140).

14. The judge also indicated that no reasonable adviser could simply have said, "it is Mr Thornhill's advice and it must be correct". This was a passing observation but may be relevant in future cases where financial advisers simply rely on the supportive influence of a favourable opinion from eminent tax counsel. There is now no doubt that such an adviser must critically assess such advice and will be negligent if this is not done. See the analogous situation where a solicitor seeks to defend a claim by relying on advice taken from Counsel: the solicitor remains obliged critically to evaluate the advice, not to follow it blindly.

15. The fact that the Defendant had, perhaps unusually, permitted prospective investors to have access to his opinions, rather than a summary account of them provided by the Sponsors, did not suffice to give rise to a duty of care. Neither did the Defendant's decision not to make an express disclaimer of liability to the Claimants sway the balance in favour of the latter (§90).

16. The judge also found useful the analysis of Hamblen J (as he then was) in **Brown v Innovator One** [2012] EWHC 1321 (at §1269), as to whether there had been an assumption of responsibility. These included:
    i. The commercial nature of the schemes;
    ii. The large sums of money being invested: the minimum investment in this case was £400,000;
    iii. The sophisticated nature of the Claimants, from which it followed that they could reasonably be expected to have read and understood the scheme documents, including the IM, and to have appreciated that they were being warned to take their own independent advice;
    iv. The fact that persons such as the Claimants would be readily able to source and pay for independent advice.

17. It is respectfully submitted that the judge's analysis is plainly correct. It is worth considering, in the context of the facts, the ramifications of the contrary finding that a duty had been owed.

    a. The Claimants would have persuaded the Court that their warranty to the effect that they had taken their own advice was a dead letter;
    b. The Claimants would have persuaded the Court that the role of their Independent Financial Advisers was irrelevant;
    c. The Claimants would have been able to sue a professional person whom they had neither retained to advise them nor paid to advise them;
    d. The Claimants, all wealthy and sophisticated persons investing large sums in a commercial venture designed to reduce their tax liabilities, could throw the risk of failure of such a venture on a professional whom they did not engage to advise them.

18. It is submitted that such a finding would have been counter-intuitive and unjust.

19. The judge found that his conclusions were not affected by certain other cases, which are frequently cited when attempting to fix a duty of care upon a lawyer in relation to a third party. His explanation of and approach to these cases is of general interest.

20. He distinguished **Estill v Cowling Swift & Kitchen** [2000] Lloyds LR 378, a case of negligent advice and drafting of a trust, on the basis that the trustees were "in substance the clients of counsel" notwithstanding that the barrister had, in form, been instructed by the settlor. He did not consider that the case of **Mathew v Maughold** [1995-1997] PNLR 309 was of material assistance because there was no substantial analysis of the problem at hand. This comment is of general assistance because the case is indeed relatively briefly analysed and in any event arose in 1987, when the general shape of the law in this area differed from the modern position.

21. Finally, he considered **Dean v Allin & Watts** [2001] PNLR 39, where a solicitor acting for a borrower was held to owe a duty of care to the lender in relation to the provision of security. He pointed out the unusual features of the case: first, that the solicitor's client, the borrower, had specifically instructed the solicitor to deal with the security to be held by the lender; second, that the unsophisticated lender did not have a solicitor acting; and third, that the solicitor neither disclaimed a duty nor advised the lender to take independent advice.

22. It is submitted that the Judge's analysis of these somewhat difficult cases is accurate and that it confirms that a duty of care will be owed "to the other side" only in exceptional circumstances.

23. The judge also rejected an argument that, because the Claimants later became members of the LLPs (and because the Defendant had in two of the three schemes been retained by the LLP), this meant that the Claimants were owed a duty of care. The judge pointed out the consequences of accepting such a submission, including that it would follow that any adviser to a company would owe a duty to a person considering subscribing for shares. See §117.

24. Finally, on the duty issue, the judge held that UCTA 1977 was not engaged. He held that the various features of the documentation went to the question of the primary obligations (if any) of the Defendant to the Claimants. He decided that the documentation did not, strictly, amount to a notice or notices disclaiming liability (and in any case had not been issued by the Defendant), but indicated that no duty was owed. In so doing, he held that the analysis of the House of Lords in **Smith v Bush** [1990] 1 AC 831 has been overtaken by the test in **NRAM** (see above). He characterised the approach of the House in **Smith** as being that "the wording of the disclaimer was not relevant in establishing the duty in the first place but went only to excluding it". In the Judge's view, as the law now stands, the question comprises the two limbs which he derived from **NRAM** and is to be answered on an objective analysis of all the relevant facts.

25. It might be argued that this is a somewhat bold step to take at first instance. It will be interesting to see whether this analysis is confirmed, either on any appeal or in another case.

Breach of Duty

26. The Judge considered the Defendant's advice about, and conclusions as to, the viability of the scheme at length. He held that the Defendant's advice had not been negligent, because it was advice that a reasonably competent tax silk could properly have given. This note does not consider the detailed analysis of the authorities in the field of tax which gave rise to this conclusion.

27. Of more general interest is the consideration of the alleged duty to warn of risks, specifically the risk that an adviser (even if not negligent in his or her analysis) might arrive at a conclusion with which a Court subsequently disagreed. It is now well established that a failure in an appropriate case to give this risk warning may be negligent: see e.g. **Barker v Baxendale Walker** [2018] 1 WLR 1095 (CA). The **Barker** principle is a dangerous allegation for a professional who gives advice on a debatable point, because it allows for a "second layer" of allegation: that is to say, a claimant can allege that the opinion expressed may not have been negligent, albeit it proved ultimately to be wrong, but the professional remains liable because of a failure to advise of the risk that he or she might be incorrect.

28. The dilemma for the professional was well expressed per Sedley LJ in the earlier case of **Queen Elizabeth Grammar School v Banks Wilson** [2001] EWCA Civ 1360, as follows:
"*Clients…want two inconsistent things. They want confident advice on which they can act, and they want cautionary advice about the risks of doing so. It is a solicitor's unhappy lot to have to try to satisfy both requirements simultaneously.*"

29. But in this case, the judge pointed out that the Claimants were not the clients of the Defendant, so that this dilemma did not arise (§340). The Defendant only had the most general knowledge of the likely characteristics of the investors and no knowledge of their specific circumstances. Therefore, this duty was not engaged.

30. It is respectfully submitted that the Judge was clearly right about this point. The primary obligation of the professional is to give competent advice. The question of how such advice should be caveated, in what terms and with what emphasis must surely vary according to the sophistication, understanding and objectives of the client: which pre-supposes the existence of the very client relationship which was absent in this case. Further the Defendant here was giving advice at a level of abstraction which is absent in the usual professional liability case. He was advising about the tax issues at a general level rather than as applied to the circumstances of a particular investor.

Causation & Duty

31. The fact that the Defendant's actual client was the Sponsors and not the Claimants gave rise to a further defence which the judge held was well founded.

32. The Claimants' case was that had the Defendant advised (as they would have it) competently, they would not have entered into the schemes. But as the judge held (§344) this involved the proposition that the Defendant had discharged its duty to the Sponsors. It therefore resolved itself into an allegation that the Defendant owed a duty to the Claimants properly to advise a third party (the Sponsors). As the judge found:

"*it would… impose on a range of advisers a duty as gatekeeper to prevent their client [the Sponsor] from doing things that might cause other people [the Claimants] loss, as long as it could be proved that the client would not have done these things but for the professional's advice. It would in effect render the professional liable in an indeterminate amount for an indeterminate time to an indeterminate class*".

33. The judge concluded, it is submitted correctly, that so to hold would run contrary to the dictum of Cardozo CJ in **Ultramares v Touche** (1931) 174 NE 441, which has been consistently applied by the House of Lords and the Supreme Court.

Limitation

34. The judge held (consistently with recent authority e.g. **Cole v Scion** [2020] EWHC 1022 (Ch), **Champion v Halsall** [2017] EWHC 1079 (QB)) that the primary limitation period commenced on the date when the Claimants invested into the schemes. This was so, in his view, irrespective of the fact that it was not then certain that HMRC would investigate the schemes or challenge the reliefs claimed (§381). It is submitted that this finding is clearly correct.

35. The Claimants relied on an alleged failure to correct initially wrongful advice: but, as the judge held, this does not give rise to a fresh cause of action nor otherwise extend the limitation period. See **Capita v RFIB** [2015] EWCA Civ 1310.

36. Certain of the Claimants would have defeated the limitation defence in reliance on section 14A of the Act, for the reasons given by the judge at §409. The general thrust of his reasoning was that the letter from the Sponsors, relating the fact of the HMRC enquiry, which was relied on by the Defendant as triggering the running of time, did not cause a reasonable claimant to think that something had gone wrong: because it had always been known (e.g. from the terms of the IM) that an enquiry might be raised. The judge followed the approach in **Cole**.

37. It is submitted that the Judge was clearly correct, since the present case was more difficult for the Defendant than **Cole**. In **Cole** the Defendant submitted that knowledge was established because there was a disjunct between advice to settle the HRMC enquiry, and earlier,

confident advice from the defendants that HMRC had utterly misunderstood the position. Nugee J disagreed with the defendant that the disjunct was sufficiently clear to a reasonable person in the position of the claimants, so that they should have realised that something had gone wrong; but that decision turned on the facts and the correct reading of the correspondence.

38. The moral is that in any case of this type much will turn on what a reasonable recipient of correspondence would have concluded. As Nugee J observed in **Cole** the essential question is, would the recipient have gone to an adviser and asked "do I have a problem?" or would he have said, "I know I have a problem: how serious is it?". In the former case there would not be knowledge until the question was answered, but in the latter case there would be knowledge from the date of receipt of the relevant correspondence.

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