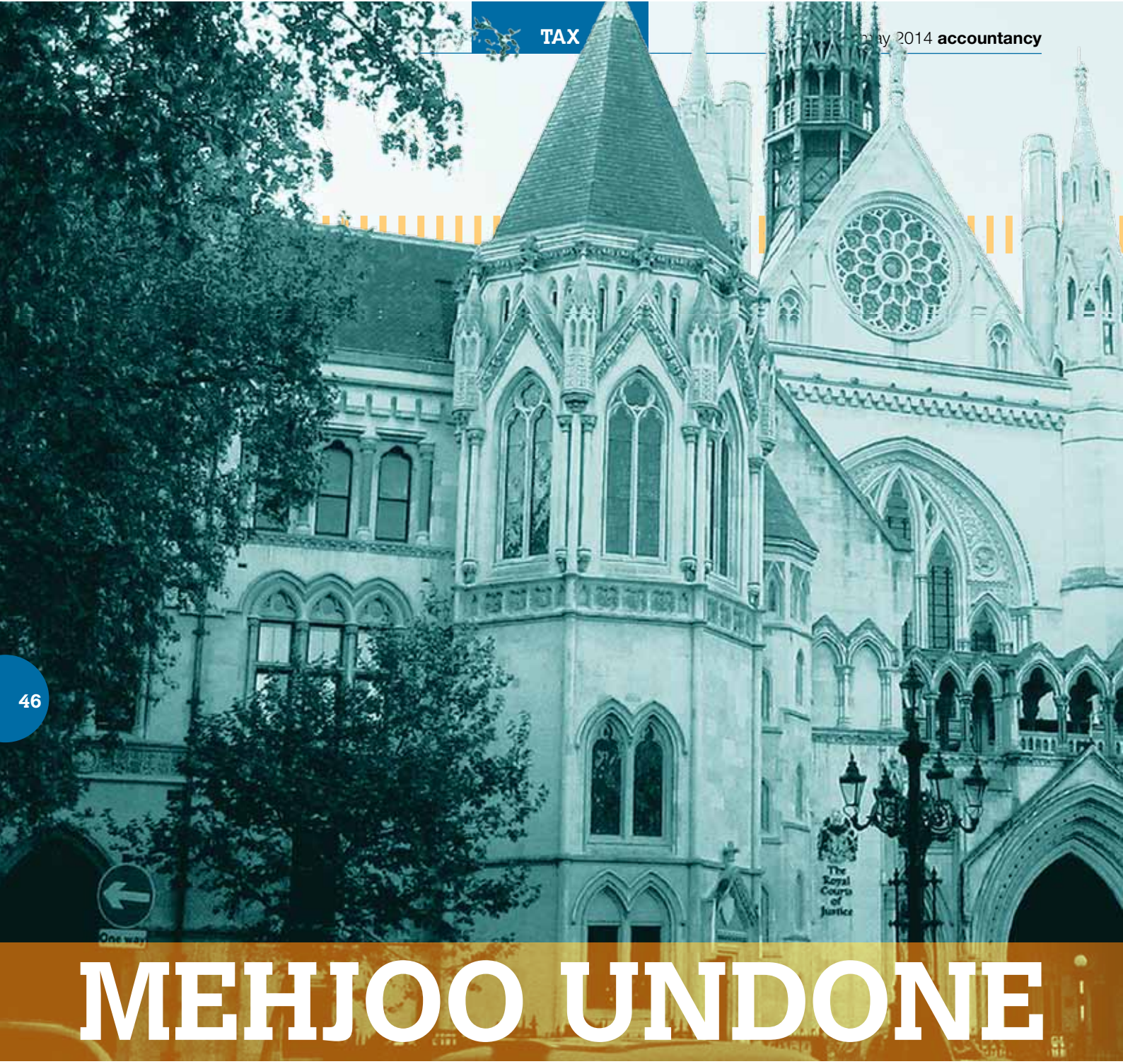

MEHJOO UNDONE

Peter Rayney assesses the implications of the Court of Appeal's refusal to back Mehjoo's case

The case of *Mehjoo v Harben Barker [2004] EWCA Civ 358* has very important implications for the scope of the duty of care owed to clients when giving advice. So it is not surprising that accountants, tax advisers and lawyers have been following the developments in this case with keen interest. The key facts of the case are summarised in the box (see page 47).

The High Court had previously ruled that Hossein Mehjoo's accountants, Harben Barker (HB), a firm with offices in the West Midlands, had been negligent. It found that since Mehjoo was very likely to be non-UK domiciled, this would have a bearing on his capital gains tax (CGT) liability. HB should therefore have advised him to seek advice from a non-dom tax specialist. The judge indicated that he was not a tax expert and that the case should have been heard by a tax judge. However, he concluded that had Mehjoo sought specialist advice, he would have learned about the Bearer Warrant Scheme (BWS) and would have been able to avoid the CGT on the sale of his company.

COURT OF APPEAL REVERSAL

In the Court of Appeal, Lord Justice Patten was not so convinced. A key finding was that Mehjoo had accepted in evidence that he would not have gone ahead with the BWS if he had been advised that there was a substantial risk of it being challenged by HMRC.

Lord Justice Patten focused on the terms of HB's engagement letter with Mehjoo, since an adviser's duty of care depended on what they had been instructed to do. Based on the terms of its engagement letter, the firm's obligations to provide tax planning advice were limited.

MEHJOO V HARBEN BARKER [2004] EWCA CIV 358

Lord Justice Patten, Lord Justice Lewison and Lady Justice Sharp
Hearing dates: 4–5 February 2014
Judgment given: 25 March 2014

SUMMARY OF THE FACTS

- Hossein Mehjoo was born in Iran to Iranian parents in 1959. He was sent to school in the UK in 1971 and has been UK resident since then.
- Mehjoo's accountants, Harben Barker (HB), had acted for him since the 1980s and had a good understanding of his family background and so on.
- In 2004, Mehjoo planned to sell his co-owned company and took advice from HB on various tax planning schemes.
- The company was sold in April 2005 and Mehjoo realised a gain of £8.5m, which after business asset taper relief, resulted in a CGT liability of £850,000.
- HB did not consider the possibility of Mehjoo being non-UK domiciled and that appropriate specialist tax advice should have been sought. Mehjoo's potential non-UK domicile status was first discussed in June 2005 and HMRC agreed his non-dom status in April 2006 (via the previous DOM 1 procedure).
- Mehjoo had subsequently learnt that he could (at the time) have used the Bearer Warrant Scheme (BWS), which would have converted his UK shares to a non-UK holding. As a non-dom, this would have enabled him to take advantage of the remittance basis and thus could have avoided his CGT liability.
- Mehjoo claimed that HB had acted negligently since they did not refer him to a 'non-dom' tax specialist or alert him to the BWS (which at the time was considered legal, but has since been blocked by legislation). Had he done so, Mehjoo claimed that he would have avoided his CGT liability.

Many accountants would, quite rightly, counsel against aggressive tax schemes that have little prospect of success

However, as is so often the case in practice, HB had created an implied duty of care to provide tax planning advice to Mehjoo, since it had done so on prior occasions.

However, Lord Justice Patten disagreed with the earlier High Court judgment in several important respects. Applying the important test of the hypothetical 'reasonably competent accountant', he found that Mehjoo's non-dom status could not influence the CGT on the sale of his UK shares unless the accountant knew how it was (potentially) possible to change the situs of the UK-registered shares into overseas assets. Lord Justice Patten said: 'As this was something which HB neither knew nor could have been expected to know was achievable, there was no reason to mention the matter, still less a liability in negligence for not having done so.'

He then went on to conclude that, in advising Mehjoo about the tax consequences of »48

selling his UK shares, the reasonably competent accountant would not have been under any obligation to discuss Mehjoo's domicile status unless it was relevant to the CGT liability on the contemplated disposal. In short, HB was not under any duty to advise Mehjoo '…about significant tax advantages which, to their reasonable knowledge, did not exist'.

Furthermore, since HB could not be expected to have knowledge of the BWS scheme, it had no obligation to tell Mehjoo to consult a non-dom specialist.

COMMERCIAL APPROACH

It is important to understand that the ruling in the *Mehjoo* case turned on its own specific and specialised facts. Nevertheless, many accountants will be relieved at the more commercial approach adopted by the Court of Appeal. The question of negligence and duty of care is always tested against the hypothetical yardstick of the reasonably competent accountant. Thus, there will be some areas of tax law and practice of which a reasonably competent accountant is expected to have a reasonable working knowledge. And, of course, for the specialist tax adviser the bar is raised even higher.

It is possible to argue that the *Mehjoo* case was played out against a different legal and moral backdrop, well before Starbucks, Jimmy Carr and the General Anti-Abuse Rule (GAAR). Many accountants would, quite rightly, counsel against aggressive tax schemes that have little prospect of success. Furthermore, all accountants now have an ethical obligation not to bring their professional body into disrepute by engaging in dodgy tax schemes.

The *Mehjoo* case reminds us of the importance of having the right engagement letter in place and the need to clearly state what the firm undertakes to provide in terms of professional services.

As someone who advises accountants on specialist tax matters, I always say that rather than 'going it alone', it always pays to seek expert advice early on when the need has been identified. This is so much better and less expensive than sorting out the proverbial mess later on.

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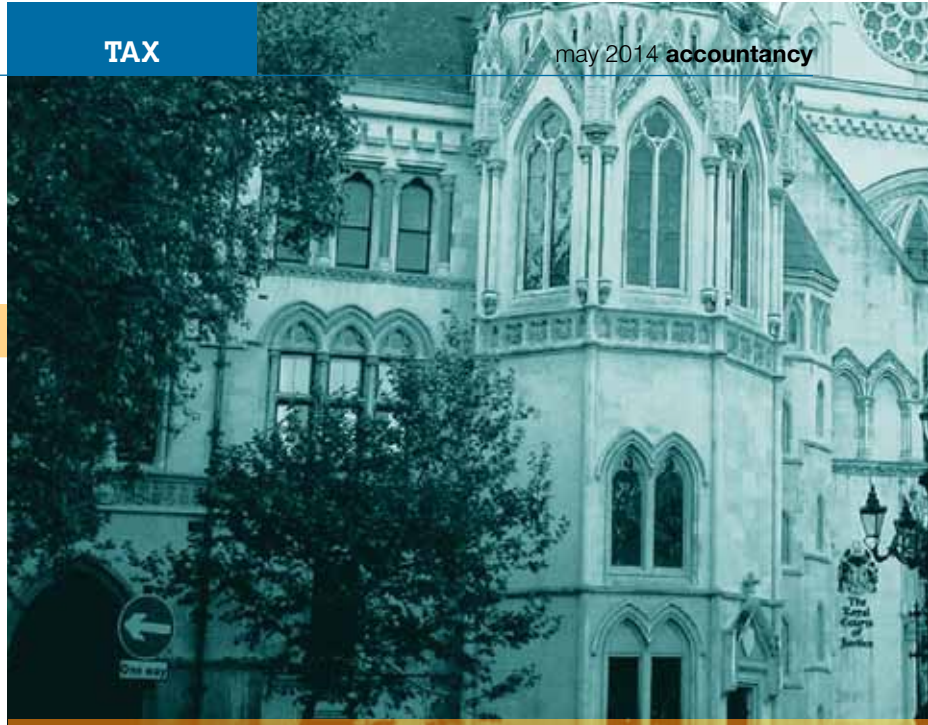

THE LEGAL

Robert Morris on the implications of Mehjoo for client relationships and the importance of tightly worded written retainers

The news that the Court of Appeal overturned the High Court's decision from last year in the case of *Mehjoo v Harben Barker* was met with sighs of relief from many, especially smaller generalist firms. The Court of Appeal's decision certainly provides some comfort for advisers to rely on the scope of a written retainer. Nevertheless, the case still contains warnings for those who allow themselves to stray beyond the scope of their written engagement.

THE CLAIM

Harben Barker (HB)'s sole written retainer with Mehjoo dated from 1999. It did not oblige them to advise him how to minimise his tax liabilities unless he specifically requested it. Furthermore, HB did not hold itself out as having specialist tax planning expertise. Nevertheless, they did volunteer some tax planning advice to Mehjoo from time to time.

In 2005, Mehjoo sold his business and incurred a CGT liability. It was this CGT liability that he claimed from HB. Mehjoo's claim was initially successful. The court concluded that, notwithstanding the terms of their retainer, through their conduct, HB had assumed a duty to advise Mr Mehjoo on tax planning in relation to the sale of his business. The court held that HB should have volunteered advice to Mehjoo that:

- he was (or was likely to be) non-domiciled;
- this had certain tax advantages; and
- he should seek specialist advice on whether his non-domicile status might enable him to minimise or eliminate the CGT that he would otherwise incur on the sale of his business.

The court concluded that had HB advised Mehjoo in this way, he would have obtained specialist advice and would then have entered into a bearer warrant scheme (a form of off-shore tax avoidance scheme, which has since

PERSPECTIVE

been rendered ineffective by legislation). In this way, the court decided, he would have avoided paying any CGT.

COURT OF APPEAL'S DECISION

HB appealed this decision and the Court of Appeal focused on two issues.

- Did HB vary the terms of their written retainer through their conduct and to what extent?
- Was HB obliged to volunteer advice to Mehjoo that he should seek specialist advice elsewhere, even though he did not specifically ask for such advice?

The Court of Appeal concluded that HB did act outside the scope of their written retainer by volunteering advice on how to avoid unnecessary and unforeseen tax consequences of certain transactions. In doing so, the firm's conduct varied the terms of their retainer to the extent that HB were obliged to provide general tax advice on routine tax issues. However, this did not amount to an assumption of a duty to advise on the sophisticated tax planning that formed the basis of this claim.

The Court of Appeal concluded that although HB knew that Mehjoo's potential non-dom status might have certain tax benefits, they were unaware (and it was reasonable for them to have been unaware) that his non-dom status might enable him to reduce or eliminate the CGT on the sale of his business. Accordingly, in the absence of any express instruction from Mehjoo, they were not under a duty to advise him to seek specialist advice. Thus, the appeal was allowed.

WHAT THIS MEANS FOR ADVISERS

The Court of Appeal's decision emphasises a reluctance to impose duties on advisers that go beyond what they are specifically requested, or agree, to do. It provides support for the ability to rely on the scope of a written retainer. In addition, the case makes it clear that a generalist firm is not obliged to refer clients to specialist advisers unless there is a good and apparent reason to do so (for example, being aware that non-dom status opened up additional routes for CGT mitigation).

The most carefully crafted engagement letter will be significantly diluted if the adviser acts beyond that engagement over a period of time

DON'T STRAY BEYOND WRITTEN RETAINER

It is often the case that advisers will follow a laudable urge to help clients beyond the scope of a written retainer. Unfortunately, this often causes problems when things go wrong. The most carefully crafted engagement letter, clearly setting out what the adviser will (and will not) advise on, will be significantly diluted if, in fact, the adviser acts beyond that engagement over a period of time. Defining the scope of the adviser's duty then becomes difficult to judge and gives room for the client to allege that the adviser failed to do something he should have done.

In this case, HB did stray from the terms of their written engagement and in doing so assumed additional duties of which they may not have been fully conscious. While the Court of Appeal was ultimately satisfied that they hadn't gone so far as to impose a duty that caused a liability in this case, this was a question of degree. Had HB held itself out as having tax planning expertise, for example, the court may have been more willing to conclude that they were liable.

Accordingly, firms are still well advised to revise their retainer letters on a regular basis and to avoid straying too far from the agreed retainer with the advice they are actually giving. If a client wants additional help (or if you think the client should be offered additional services), it is far better to agree the same in a revised engagement letter. In that way everyone's responsibilities will be clear and retrospective arguments about advisers' negligence become harder.

DUTY TO REFER TO SPECIALISTS

Generalist advisers should note that the Court of Appeal confirmed that a duty does exist to refer clients to specialists where there is a good reason to do so. Failing to refer a client in such circumstances not only risks a claim that a referral should have been made, but also increases the possibility of the adviser straying into an unfamiliar area and inadvertently providing inaccurate advice.

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