



TRENDS SEEN ON CLAIMS AGAINST SMALL ACCOUNTANTS AND HORIZON SCANNING

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As the insurance industry faces daily challenges in keeping up with emerging risks, we take a moment to consider legal developments in claims against the more 'traditional' accounting profession over the past 12 months. We consider the trends that we are seeing in this sector and provide our insight into how we see the landscape evolving in 2018.

CLAIMS - TRENDS WE ARE SEEING

Claims against small accountants fall into five main categories.

1. Tax

HMRC is continuing with its clampdown on tax schemes, resulting in many investors finding themselves with significant liabilities that they claim they were not prepared for. Examples of schemes, promoters and intermediaries we have come across include:

- Clean Energy - various green energy projects
- Ingenious - film finance schemes
- Scion - film finance schemes
- Montpelier - EBTs and other schemes
- Blackstar and Invicta.

Some tax experts/organisations were holding workshops and conferences providing information about these schemes to small accountants in or around 2010/2011.

Although there are good limitation arguments on some of the more recent claims, limitation largely depends on the circumstances of each individual claim or the scheme involved. Claimants frequently claim they have only recently had the requisite knowledge required to bring the claim following receipt of a tax demand or a court decision. As they have three years from date of knowledge to issue we expect to continue to see notifications on some types of scheme for at least two-three more years.

We are seeing an increase in claims relating to Employee Benefit Trusts (EBTs) and Employer Financed Retirement Benefit Schemes (EFRBs). Anti-avoidance legislation introduced in Part 7A of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) via the Finance Act 2011 was designed to ensure that tax on employment income is not avoided or deferred through the use of trusts or other intermediaries, such as EBTs and EFRBs. However, many intermediaries continued to promote EBTs (which were designed to dodge the legislation introduced in 2011) and have only recently started to advise investors to settle.

The claims for each EBT tend to be small but some claimants have placed funds in between three to six EBTs in several consecutive tax years! Amounts claimed vary from between £250,000 to £750,000 with settlements generally being around one third of the amount claimed. There has also been a high profile Supreme Court decision following a long legal battle in the Glasgow Rangers case. The Supreme Court found in favour of HMRC and held that payments that were made through EBTs should be correctly considered taxable income. This decision has wide ranging implications, demonstrating the tough line that the court will take to tax avoidance (but posing wider questions, which require clarity from HMRC, on 'disguised remuneration').

We continue to see claims arising out of advice on Enterprise Investment Schemes (EIS), Seed Enterprise Investment Scheme (SEIS) and Business Property Relief (BPR) during corporate transactions, primarily due to failure to advise properly on the complicated qualifying criteria. These claims can be difficult to defend (unless you can rewind the share purchase transaction) and can lead to large losses.

Other tax claims we are continuing to deal with include those arising from venture capital trusts (VCT); failure to register for VAT; and claims involving missed deadlines to make research and development (R&D) tax claims.

2. Claims against insolvency practitioners

These are often brought as misfeasance claims under Section 212 of the Insolvency Act 1986, for example alleging that liquidators have sold assets at an undervalue. Claims can be brought by:

- Creditors of the company that the IP was dealing with
- Former directors
- New IPs who have taken over.

Sometimes these claims are driven by HMRC who are trying to collect outstanding tax.

These claims can be quite tricky to pull apart as in the ordinary course of a liquidation or administration there are many considerations that an IP will have to deal with. A recurring issue in these claims is the 'loss of chance' aspect, with claimant solicitors failing to take into account what the IP could have clawed back had they acted as the claimant says they ought to have. Often, it transpires that the company or creditor would have been in exactly the same position in any event.

These claims always increase following a recession, with claims invariably issued as they come up against limitation.

3. Corporate Finance

Claims frequently arise from share valuations and deals. We are seeing post-recession hindsight claims with claimants arguing they were sold short on asset values, comparing what assets are worth now and 'forgetting' how much values dropped in the recession.

4. Claims against forensic accountants

We have seen claims against forensic accountants increase following a decision a few years ago which effectively lifted immunity from suit in this area. However, it is difficult to establish liability unless there is a blatant breach of duty based on an opinion which is clearly incorrect.

5. Audit

We are dealing with a number of audit claims relating to frauds by company secretaries or employees. Again, these tend to increase following a recession but we would not say that we are seeing a marked increase at this time. However, we anticipate the number will rise as limitation periods approach.

CRYSTAL BALL GAZING

Tax schemes

There will always be claims relating to tax reliefs and attempts to avoid tax. We anticipate that we will continue to see claims arising from tax schemes and would expect to see claims relating to EBTs and other attempts at disguised remuneration for at least another three years (due to limitation periods).

Under measures proposed in the Finance Bill 2017, HMRC will have the power to attack loans made from EBTs since 6 April 1999, even if there has been no distribution from the EBT. Earlier this year, HMRC published a settlement opportunity for employers who have used EBTs in the past and there has been a lot of publicity relating to their use in recent months.

We predict that as a result of the clampdown on EBTs and other schemes, there may be secondary claims against firms who have taken over advising investors (or the original tax advisors) who told the claimants two to three years ago not to accept the settlement opportunities which were then on the table. That said, we would not expect the claims to be for large sums, if the investors bother to pursue them at all.

Tax reliefs

We expect to continue to see claims relating to tax reliefs such as R&D claims, EIS relief and so forth. There have also recently been large increases in SDLT rates which may well lead to an increase in claims against accountants who fail to advise on ways to mitigate their clients' tax burden following property sales. There can be very large amounts at stake on these property transactions and therefore the quantum of claims could be very high. These claims will take a little time to work through the system.

Probate

The Institute of Chartered Accountants in England and Wales now has the power to regulate probate and licence alternative business structures. We predict that accountants will continue to apply to their regulators for a probate licence as many see this as an easy additional income stream, particularly as other sources of work decline and their competitors start to offer the service.

Many accountants have been slow to get involved in this area and as there is naturally a time lag between the work being done and claims being pursued, we may still see an increase of claims of this type. Probate has generally been a fertile area of claims against solicitors, for example in respect of missed deadlines on contested probate claims and mishandling of the administration of estates. Accountants with a probate offering will open themselves up to the risk of similar claims.

Data privacy

As everyone is aware, the GDPR is operational from May 2018. Given the level of personal data being held by accountants they should already have compliance steps in hand. Whilst fines might not be covered by the PI policies, it is not difficult to see how there might be: (a) negligence claims against accountants if there are breaches of the GDPR; and (b) a risk to the survival of an insured if they face a fine (maximum fines being 4% of worldwide turnover or €20 million, whichever is the larger).

Due to the volume and nature of data held by accountants, they are vulnerable to both internal (as a result of a malicious data breach) and external cyber attacks. Such attacks may also lead to claims if the firm does not have the necessary data security precautions and procedures in place.

FURTHER INFORMATION

To find out more about our services and expertise, and key contacts, go to: kennedyslaw.com

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