

News flash

Professional Indemnity: Accountants and Rollover Relief - Causation and Common Sense Floyd & Ors - v - John Fairhurst & Co

In this issue, Sarah Mawbey and Andrew MacLeod review a Court of Appeal decision handed down on 21 May 2004 that provides guidance on the approach that Courts should take when dealing with the relatively common occurrence of claims against chartered accountants for failing to advise upon the availability of rollover relief.

Robin Simon LLP acted on behalf of John Fairhurst & Co and their professional indemnity insurers. The Court of Appeal upheld the High Court decision of HHJ Maddocks in favour of John Fairhurst & Co.

Background

The action arose out of negligent tax advice given by John Fairhurst & Co ("Fairhursts") who were the Claimants' accountants and tax advisors. The Claimants owned land near Manchester that was compulsorily purchased by Salford City Council. Compensation was paid, which gave the Claimants a chargeable gain resulting in a liability to Capital Gains Tax ("CGT").

The Claimants had sought advice from Fairhursts as to the CGT implications of the compulsory purchase. Unfortunately, whilst Fairhursts provided correct advice on certain issues, they omitted to advise upon the availability of rollover relief ("CPO relief").

The Claimants sued Fairhursts for professional negligence. The Claimants alleged that they had suffered a loss equal to the tax paid, less a small discount for the fact that the tax would be deferred, not avoided altogether.

It is important to note that the Claimants subsequently used a large part of the compensation monies to purchase a residential property which in due course they sold in two parcels, each producing a capital gain and each with the

benefit of principal private residence relief ("PPR Relief") thus, achieving a considerable tax saving.

Principal Issue

The principal issue at the original trial was whether the First Claimant, Mr Floyd, would have taken advantage of CPO relief had Fairhursts advised him that it was available. The Court of Appeal agreed this was not a question of assessing the chance of Mr Floyd having taken advantage of CPO relief but, rather, the Judge had to be satisfied that Mr Floyd would have taken advantage of this relief on the balance of probabilities. The Judge's decision had to fundamentally be based upon his evaluation of Mr Floyd's oral evidence, in the absence of any contemporaneous documents indicating what he would have done.

The Judge determined this issue against Mr Floyd. The Judge identified three main factors which led him to his conclusion, namely:

1. Mr Floyd allowed the compulsory purchase compensation to be structured in such a way that he placed the larger part of the gain away from the Third Defendant where, based upon correct advice given by John Fairhurst & Co, it could have been sheltered from tax.
2. Mr Floyd instructed new tax advisors who alerted him to the availability of CPO relief when it was still possible to

▶ exercise CPO relief and no steps were taken to extend the time within which CPO relief could be claimed.

3. PPR relief would not have been available if CPO relief had been claimed. The residential property investment was expected to produce untaxed gains and Mr Floyd was more attracted by the prospect of having a large sum of money that he was free to invest in any way he chose.

The Court of Appeal upheld the trial Judge's decision. It held that the Judge approached the issue in a logical and methodical way. He took the evidence of Mr Floyd as his starting point and then tested it by reference to various objective factors which could be expected to throw light on the reliability of his evidence.

The Court of Appeal agreed that in order for the Judge to reach his conclusion on this hypothetical issue, he had to build up a model of Mr Floyd, identifying his individual characteristics: his strengths and weaknesses, knowledge, experience, proclivities, temperament, financial position and so on. The Judge then had to ask what, hypothetically, a person with all those characteristics would have done if he had been given the correct advice.

Subsidiary Issues

The Court of Appeal considered a number of other issues. Two of these are particularly relevant to the quantification of claims of this nature.

Discount to reflect the fact that CPO relief would only have resulted in a deferral of tax liability

This issue concerned the damages that would have been payable to Mr Floyd if he had proved that he would have taken advantage of CPO Relief had he been properly advised. Again, the Judge was required to evaluate Mr Floyd's oral evidence to decide the likelihood that the liability to pay the deferred tax would crystallise: for example whether Mr Floyd would have decided, at sometime in the future, not to continue investing in property subject to CPO Relief.

The Judge held that because the liability to tax was merely deferred, he would have applied a discount of 25%.

Although this point did not require a decision by the Court of Appeal (given their conclusion on the main issue above), the Court of Appeal nevertheless concluded that the 25% discount was one that the Judge could reasonably have reached in this case.

Whilst each individual case will turn upon its own facts, this aspect of the Court of Appeal's decision appears to be authority to support an argument that a discount (in some amount) should always be applied in a similar case.

Credit for tax savings made on alternative investments

The Judge also held that the Claimants would have had to bring into account (before the discount of 25% was applied) the tax savings which they achieved by claiming PPR relief on the sales of the residential properties.

The Court of Appeal upheld this decision. The Judge was correct to require the tax savings made to be brought into account, on the basis that the Claimants could not have made those tax savings if they had elected for the CPO Relief and would thus have recovered more than their loss if those tax savings were not brought into account.

Court of Appeal's power to interfere with findings of fact of the lower Court

Before reaching its decision on the issues of the appeal, the

Court of Appeal necessarily had to consider its power to review findings of fact made by a lower Court and substitute its own findings where appropriate. The Court of Appeal reviewed and summarised the position under both CPR Part 52 and the leading authorities on this issue, including *Benmax v. Austin Motor Co Limited [1955]* and *Assicurazioni Generali SPA v Arab Insurance Group [2003]*. In *Benmax* the House of Lords drew a sharp distinction between two types of findings of fact: namely findings of specific/primary fact and findings of fact which are really inferences from specific/primary facts. The House of Lords held that in the latter case, the appellate tribunal will more readily form an independent opinion than in the case of findings of specific/primary facts, particularly when the finding was based on the witness's credibility.

Applying the principles set out in the various authorities, the Court of Appeal stated that in determining whether a factual finding is of a type which an appellate court should only set aside with reluctance, it is relevant to ascertain whether the finding was based on the Judge's findings as to the credibility or reliability of a witness's oral evidence and also whether the finding is in truth a complex evaluation of a number of factors which the Judge would have made based on his perception of the case over the course of the trial.

In cases where a factual finding is based on the credibility or reliability of oral evidence or involves the more complex evaluation the appropriate standard to be applied is whether the Judge's finding went beyond the margin within which Judges can legitimately differ (referred to as the Judge's "margin of appreciation").

The Court of Appeal considered the finding of fact on the principal issue in this case involved an evaluation of a number of factors including Mr Floyd's oral evidence where the appellate court should be reluctant to interfere with Judge's findings. In any event, the Court of Appeal was satisfied that the Judge's conclusion had been properly reached.

Should you have any questions arising out of this case please do not hesitate to contact Sarah Mawbey or Andrew MacLeod at Robin Simon LLP, Manchester:

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