CGT / IHT Tax Trap & Professional Negligence

Generally speaking, the disposal of an asset *"otherwise by way of a bargain made at arm's length"* is treated for CGT as made for consideration equal to the market value of the asset, **Taxation of Chargeable Gains Act 1992 (TCGA 1992) S.17(1)(a)**.

A disposal *"otherwise by way of a bargain made at arm's length"* is made where an asset is gifted, or is sold for consideration less than market value.

A disposal between *'connected persons'* (**TCGA 1992 s.286**) is always treated as a transaction made *"otherwise by way of a bargain made at arm's length"* (**TCGA 1992 s.18(2)**).

By way of exception to the general rule that the transferor is deemed to receive the market value of the asset given away (even where in fact he has received nothing) and the transferee is deemed to have paid market value (even where he has paid nothing), are disposals between spouses (and civil partners) living together, which are automatically deemed to take place on a *'no gain, no loss'* basis (**TCGA 1992 s.58**).

The assets of a deceased person of which he was competent to dispose are deemed to be acquired by his personal representatives at their market value at death, which results in an uplift in the value of the assets but no charge to CGT (**TCGA 1992, s.62(1)**).

If a donor does not survive the making of a lifetime gift of property to an individual by more than 7 years, this can result in the worst of all worlds, i.e:

1. a failed PET for IHT; and

2. loss of the CGT-free uplift that would otherwise have been available on his death, because the donor did not own the asset at the date of his death.

Lifetime transfers which are PET's do not attract an immediate IHT charge. Consequently hold-over relief under **s.260 TCGA 1992** is not available, even if the PET becomes subsequently chargeable because of the death of the transferor within seven years. **s.260 (2)(a) TCGA 1992** provides,

'A disposal is within this subsection if it is made otherwise than under a bargain at arm's length and -
(a) is a chargeable transfer within the meaning of the Inheritance Tax Act 1984 (or would be but for section 19 of that Act) and is not a potentially exempt transfer (within the meaning of that Act).'

Gifts to and by companies do not attract hold-over relief even though they are not PET's (unless of course the gift to a company is of a business asset other than shares, when relief may be available under **s.165 TCGA 1992**).

Held-over gains on the creation of a trust are not wiped out on the death of the interest in possession beneficiary, although gains on assets accruing over the trust's period of ownership, when the beneficiary has a qualifying interest in possession are generally wiped out on his death provided that the property does not revert to the settlor (**TCGA 1992, ss.72 and 73**).

FA 2006 amended **TCGA 1992, ss. 72** and **73** so that if the interest in possession arises on or after March 22, 2006 there is no deemed disposal or base cost uplift to market value on death of the interest in possession beneficiary unless;

1. the interest was an IPDI;
2. a disabled person's interest within **IHTA 1984 s.89B(1)(c)** or **(d)**;
3. an 18-25 trust where the beneficiary had an interest in possession and died

under 18; or

4. a bereaved minor trust and the minor had an interest in possession.

See - http://www.step.org/lifetime-gifts; McCutcheon on Inheritance Tax paragraph 6-73; Revenue Law Principles and Practice, paragraph 24.2; and Trust Taxation And Estate Planning, paragraph 46.34.

A financial advisor, accountant, or solicitor, who has neglected to alert their client to the existence of the specific matrix of CGT and IHT rules which underlie this elephant-sized tax trap, may be liable in damages for professional negligence, for which they should have professional indemnity insurance.

The precise scope of an advisor's duty to advise, depends amongst other things upon the extent to which the client appeared to need advice. An inexperienced client is entitled to expect his professional advisor to take a much broader view of the scope of his retainer and of his duties than will be the case with an experienced client. The test is what the reasonably competent practitioner would do having regard to the standards normally adopted by his profession, which is directly related to the confines of the retainer, ***Midland Bank v Hett, Stubs & Kemp*** **[1979]**. In ***Cancer Research Campaign and ors v Ernest Brown & Co (a firm) and ors*** **[1997]** the extent of a solicitor's duty to give tax advice about the IHT savings that could have been achieved by the making of a post-death variation was expressed by Mr Justice Harman in the following terms,

'I do not doubt the solicitor, in considering the will, must consider what inheritance tax complications that testator will cause by the bequests for which he is given instructions. But I refuse to hold, extending the duty to advise by, it was said, analogy, that there arises a duty to inform the intended testator, who has come in to instruct a solicitor about his or her will, about tax avoidance schemes in connection with some quite other estate.'

In a client care letter a solicitor can expressly carve out the giving of tax advice from the scope of his retainer. Regarding the existence of a duty to give tax advice see ***Carradine Properties Ltd v DJ Freeman & Co*** **[1999]**, and ***Hurlingham Estates Ltd v Wilde & Partners*** **[1997]** where a duty to give tax advice was held to exist in a property transaction.

Unless instructed expressly, a solicitor does not normally have a duty to advise his client about the commercial wisdom of a transaction, particularly where the client was an experienced businessman. However, if in the course of carrying out his retainer, the solicitor becomes aware of a risk, or potential risk to his client, he is under a duty to inform his client. In ***Gabriel v Little & ors*** **[2013]** the judge stated the following principles,

'The starting point is that a solicitor's duty is to be measured against his retainer. This has been well settled since at least ***Midland Bank Trust Co Ltd v Hett Stubbs & Kemp*** **[1979]**. *It was explained in* ***Pickersgill & anr v Riley*** **[2004]**, '[as] *to the extent to which a solicitor should make enquiries or investigate matters that he has not been asked to enquire into or investigate, their Lordships think that para 10-160 in Jackson & Powell on Professional Negligence (5th ed, 2002) correctly states the position: 'In the ordinary way a solicitor is not obliged to travel outside his instructions and make investigations which are not expressly or impliedly requested by the client.' In support of that proposition the text goes on to refer to* ***Clarke Boyce v Mouat*** **[1994]**, *a Privy Council decision, where Lord Jauncey of Tullichettle said, at p.437: 'When a client in full command of his faculties and apparently aware of what he is doing seeks the assistance of a solicitor in the carrying out of a particular transaction, that solicitor is under no duty whether before or after accepting instructions to go beyond those instructions by proffering unsought advice on the wisdom of the transaction.' And in* ***Reeves v Thrings & Long*** **[1996]** *Sir Thomas Bingham MR said, at p.275, in a dissenting judgment: 'It will always be relevant to*

consider what the solicitor is asked to do, the nature of the transaction and the standing and experience of the client…it was in my view [the solicitor's] *duty to draw* [his client's] *attention to any pitfall, particularly any hidden pitfall, the contract might contain.' Simon Brown LJ said, at P.279: 'I cannot accept that* [the solicitor] *was under any further duty to his client, any duty to advise him upon the commercial implications or importance of the access provision or to warn him against the risks that it might pose for the future development, operation or sale of the hotel. These matters are well within the client's competence to appreciate and evaluate for himself business considerations rather than legal ones. Nevertheless, the principle that a solicitor's duty is strictly circumscribed by his instructions must not be taken too far.* [Counsel] *referred me to the observations of Laddie J in* ***Credit Lyonnais v Russell Jones & Walker*** **[2002]***: 'However, if, in the course of doing that for which he is retained, he becomes aware of a risk or a potential risk to the client, it is his duty to inform the client. In doing that he is neither going beyond the scope of his instructions nor is he doing extra work for which he is not to be paid. He is simply reporting back to the client on issues of concern which he learns of as a result of, and in the course of, carrying out his express instructions. In relation to this I was struck by the* [following] *analogy. If a dentist is asked to treat a patient's tooth and, on looking into the latter's mouth, he notices that an adjacent tooth is in need of treatment, it is his duty to warn the patient accordingly. So too, if in the course of carrying out instructions within his area of competence a lawyer notices or ought to notice a problem or risk for their client of which it is reasonable to assume the client may not be aware , the lawyer must warn him.' I think that this passage accurately reflects the legal position.'*

Whilst a professional advisor is not necessarily liable for all the consequences of the client entering into a transaction, they are liable for losses falling within

the scope of the duty which had been broken. In ***Gabriel v Little & ors*** **[2013]** the judge referred to the following passage from the judgment of Lord Hoffmann in ***South Australia Asset Management Corp v York Montague Ltd*** **[1997]**: *'...a person under a duty to take reasonable care to provide information on which someone else will decide upon a course of action is, if negligent, not generally regarded as responsible for all the consequences of that course of action. He is responsible only for the consequences of the information being wrong. A duty of care which imposes upon the informant responsibility for losses which would have occurred even if the information which he gave had been correct is not in my view fair and reasonable as between the parties. It is therefore inappropriate either as an implied term of a contract or as a tortious duty arising from the relationship between them. The principle thus stated distinguishes between a duty to provide information for the purpose of enabling someone else to decide upon a course of action and a duty to advise someone as to what course of action he should take. If the duty is to advise whether or not a course of action should be taken, the adviser must take reasonable care to consider all the potential consequences of that course of action. If he is negligent, he will therefore be responsible for all the foreseeable losses which is a consequence of that course of action having been taken. If his duty is only to supply information, he must take reasonable care to ensure that the information is correct and, if he is negligent, will be responsible for all the foreseeable consequences of the information being wrong.'*

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I specialise in professional negligence claims against financial advisors, accountants, and solicitors, and to arrange an initial fixed fee meeting in London to discuss the merits of your claim, please telephone the Clerks at 1 Essex Court on 0207 936 3030, or email your enquiry to clerks@1ec.co.uk.