The Duty of Solicitors to Give Tax Advice —A Reply

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The decision of Lightman J in Hurlingham Estates v Wilde & Partners *has led some commentators to warn that solicitors now owe a duty to advise their clients on the tax aspects of whatever matter they are acting in. The author argues that the decision does not stand for such a broad proposition, the conclusion in that case being dictated not by an extension of principle but by its extreme facts.*

IN the last issue of *The Review,* there appeared a piece by Mr RK O'Connor QC entitled 'The Duty of Solicitors to Give Tax Advice: Recent Developments'.[1] Mr O'Connor, after analysing two recent cases, the first a decision of Lightman J in *Hurlingham Estates Ltd v Wilde & Partners*,[2] the second an unreported decision of a Master of the Western Australian Supreme Court,[3] concluded as follows:

> Clearly, the position is that solicitors have a duty to advise their clients on the tax aspects of whatever matter they are acting in. Alternatively, they must obtain from another tax-competent practitioner the necessary specialist tax advice for the benefit of the client. Failure to do this could result in the solicitors being held liable to the client for negligence and/or breach of contract.[4]

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1. (1998) 27 UWAL Rev 195.
2. (1997) 1 Lloyd's Rep 525; (1996) 37 ATR 261.
3. The decision was *Briar Holdings v Capolingua* (unreported) WA Sup Ct 25 July 1997 no 970368. This decision is not discussed in this article because the finding was that no cause of action had yet accrued.
4. O'Connor supra n 1, 202.

These are alarming words, especially that first sentence: solicitors have *a duty to advise their clients on the tax aspects of whatever matter they are acting in.* Given that there are few areas of civil law practice that are immune from the reaches of taxing statutes, and hence the need to furnish tax advice, if Mr O'Connor's assessment of the case law is correct, the very complexity of tax law dictates that reference to a 'tax-competent practitioner' should be a standard procedure as a hedge against negligence actions.

The purpose of this article is to assess whether Mr O'Connor's conclusion is indeed an accurate interpretation of the *Hurlingham Estates* case. As a precursor to, and as background for, making this assessment, the article first discusses the law relating to the scope of a solicitor's duty of care and the requisite standard of care.

DUTY AND STANDARD OF CARE — DISCLAIMERS AND EXCLUSIONS

It is trite law to say that solicitors owe a tortious duty of care to their clients, a breach of which constitutes negligence. It is likewise trite to note that whether a breach of a duty of care has occurred depends on two matters: the scope of that duty and the applicable standard of care. These are different, and distinct, concepts. The traditional view is that the scope of the solicitor's *duty of care* in tort (or, in other words, the extent of the solicitor's assumption of responsibility) is prescribed by contract, namely by the terms of the retainer agreement between solicitor and client.[5] A corollary of this is that a solicitor's duty of care in tort can also be *restricted* by the terms of the retainer agreement.[6] Any such restriction operates as a de facto disclaimer of the duty or responsibility to advise outside the scope of the retainer agreement.

Conversely, even though under the general law persons providing a service can legitimately exclude liability for negligence in the performance of that service,[7] the *standard* of care required of a solicitor cannot, as a general rule, be modified by contract. In other words, the retainer agreement cannot, by means of an exclusion clause, exempt solicitors for their default in the performance of their professional responsibilities. The reasons for this are threefold. First, public confidence in solicitors, and therefore the justice system, would be reduced if the law condoned a negligent breach of a solicitor's tortious duty to a client by permitting the solicitor

5. *Hawkins v Clayton* (1988) 164 CLR 539, Mason CJ and Wilson J 544; *White v Jones* [1995] 1 All ER 691, Lord Nolan 736.
6. *Hawkins v Clayton* ibid, Deane J 582; *White v Jones* ibid, Lord Goff 699.
7. Eg *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500.

to shelter behind a broadly worded exclusion clause in the retainer agreement, thereby depriving the client of any compensation.[8] This is expressly recognised by statute in at least two Australian jurisdictions.[9] The relevant public policy in this regard is that any loss stemming from a solicitor's default in respect of a client should be borne by insurance, thus spreading the loss among those who avail themselves of legal services. Secondly, the notion of public service inherent in professionalism[10] is inconsistent with the notion that solicitors can exclude liability for their own professional defaults in serving their clients. Thirdly, as an exclusion clause in a retainer agreement is in the interests of the solicitor, and not of the client, this places the solicitor in a position of conflict of interest and duty. This can only be surmounted safely by the client's securing independent legal advice on the clause.

It follows that the way to protect a solicitor from liability for failure to give appropriate tax advice is by means of an express restriction on the scope of the retainer in the retainer agreement. No breach of the tortious duty of care in respect of the failure to give advice in a particular area of law, such as taxation law, arises because of the absence of the assumption of a duty itself. On the other hand, reference to an exclusion clause presupposes the occurrence of a breach of the relevant duty. Thus the lawyer is protected, not by lowering the appropriate standard of care, but by restricting the scope of the engagement so as to deny responsibility at the outset. This may be justified on the basis that, provided the client is informed and understands the limitations on the scope of the solicitor's advice, the client may make an *informed choice* to engage another solicitor (or an accountant, business adviser, etc) to advise on matters outside the scope of the former's retainer — or alternatively retain another solicitor who has the requisite expertise for the entire matter.

For the purposes of this article, the above issues are discussed in the context of two types of retainer: first, the retainer that specifically requires tax advice to be given,[11] and secondly, the general retainer part of which may involve or require tax advice.[12] It is the second of these which is the main focus of discussion, for it is here

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8. Barristers' immunity from claims in negligence (*Giannarelli v Wraith* (1988) 165 CLR 543) is not based on agreement but on overriding public policy: see GE Dal Pont *Lawyers' Professional Responsibility in Australia and New Zealand* (Sydney: Law Book Co, 1996) 104-112.
9. In Queensland and WA, legislation provides that a costs agreement (which is often part of the retainer or even the entire retainer) cannot exempt a practitioner from negligence: Legal Practitioners Act 1995 (Qld) s 2; Legal Practitioners Act 1893 (WA) s 59(4).
10 See D Dawson 'The Legal Services Market' (1996) 5 JJA 147.
11. See infra pp 124-125.
12. See infra pp 125-131.

that the most difficult problems arise. A brief treatment of the first form of retainer is included for the sake of completeness.

CASES WHERE THE SOLICITOR IS RETAINED TO PROVIDE TAXATION ADVICE

Where a solicitor is retained solely to provide tax advice, or advice which clearly includes tax advice, the main issue is not usually one of the scope of the tortious duty of care but rather one of standard of care. The scope of the retainer, at least in so far as the furnishing of tax advice is concerned, is in most cases clear.[13] What must be determined is whether a solicitor, in giving this advice, has acted according to the standard of a qualified, competent and careful solicitor in the practice of his or her profession.[14] As solicitors are not ordinarily retained for compliance work (which is principally the domain of accountants and tax agents), solicitors specifically retained to provide tax advice usually advise on the most tax-effective structuring of transactions and give opinions on legal points involving the interpretation and application of the tax laws.

With regard to the former, a solicitor who fails to structure a transaction in the most tax-effective fashion given the needs of, and constraints placed upon, the client can be said to have failed to meet the requisite standard of care. Moreover, the standard of care requires that the solicitor apprise his or her client of the risk that the relevant structure may be struck down by the Commissioner of Taxation (and thus be ineffective) and also other risks (eg, the dangers of building up assets in the name of other family members or any drawbacks of the structure from an insolvency perspective), in such a manner as to enable the client to make an informed judgment on the merits of proceeding with its implementation.[15]

Yet it must be remembered that a solicitor 'is only liable for the use of ordinary care and skill [and] is not bound to guarantee against all mistakes or omissions or to be gifted with powers of divination or to exercise extraordinary foresight, learning or vigilance'.[16] Hence, merely because a structure designed and implemented by a

13. Having said this, one must not overlook the situation of a solicitor who, being retained to provide taxation advice in respect of a proposed structure, attempts to limit the scope of his or her duty of care to one particular aspect of taxation, or alternatively, excludes any duty of care in respect of a particular type of taxation (eg, stamp duties). Cf *Tip Top Dry Cleaners Pty Ltd v Mackintosh* (1998) 39 ATR 30, Debelle J 52.
14. This is an expression of the standard of care expected of a solicitor in respect of advice to his or her clients: *Hawkins v Clayton* supra n 5, Deane J 580; *Hanflex Pty Ltd v NS Hope & Assoc* [1990] 2 Qd R 218, Demack J 226.
15. See *EVBJ Pty Ltd v Greenwood* (1988) 88 ATC 4977.
16. *Jennings v Zilahi-Kiss and MK Tremaine & Co Pty Ltd* [1972] 2 SASR 493, Bray CJ 512. See also *Duchess of Argyll v Beuselinck* [1972] 2 Lloyd's Rep 172, Megarry J 185.

solicitor is subsequently struck down by the Commissioner of Taxation is not conclusive evidence of a failure to meet the requisite standard of care. If, *at the time when the advice was given*, a qualified, competent and careful solicitor would have given the same advice (a matter which is assessed by examining the practice of other solicitors at the time) the standard of care has been attained, and there is no negligence.[17]

Although it is beyond the scope of this article, it must be noted that, just as a general retainer may require a solicitor to furnish tax advice, the scope of the duty of care of solicitors who are specifically retained to provide tax advice may extend beyond that advice. To this end, it has often been said that solicitors cannot view tax advice in a vacuum, in that non-tax issues (both legal and non-legal) may render otherwise tax-effective structures inappropriate for the client's needs.[18] Yet the duty may extend beyond this, for a court is likely to assume that a solicitor specifically retained to provide tax advice must nonetheless fulfil the general standard of a qualified, competent and careful solicitor. This may, in the words of Deane J, require the solicitor to take positive steps 'beyond the specifically agreed professional task or function' where necessary to 'avoid a real and foreseeable risk of economic loss being sustained by the client'.[19]

CASES WHERE THE SOLICITOR IS RETAINED TO PROVIDE GENERAL ADVICE—HURLINGHAM ESTATES

Hurlingham Estates Ltd v Wilde & Partners[20] dealt both with the issue of the scope of a solicitor's duty of care and the requisite standard of care in the context of tax advice given as part of a general retainer. The basic facts of the case can be recited briefly. The defendant solicitors acted for the plaintiff in a restructuring transaction, part of which involved the acquisition of a lease of business premises. The solicitors structured the transaction in such a way as to expose the plaintiff to a substantial (£61 000) tax liability. The plaintiffs alleged that the solicitors had been negligent in failing to structure the transaction in a manner which would have avoided that liability.

The issues before the High Court (Chancery Division) were twofold: first, what was the *scope* of the duty of care owed by the defendants to the plaintiff?

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17. See *Doug Sim Enterprises Pty Ltd v Patrick Wan & Co* (1987) 88 ATC 4078, Kelly SPJ 4080.
18. See RH Woellner, TJ Vella, L Burns & S Barkoczy *Australian Taxation Law 1998* 8th edn (Sydney: CCH, 1998) 1534-1537.
19. *Hawkins v Clayton* supra n 5, 579.
20. Supra n 2.

Secondly, on the assumption that the scope of the defendants' duty encompassed tax advice, did the defendants fulfil the required standard of care? As to the first of those issues, the defendants contended that their retainer did not extend to the provision of advice on the taxation aspects of the relevant transaction. Lightman J rejected this contention, pointing to the absence of any express term in the retainer agreement to this effect.[21] Having reached this conclusion regarding the first issue, his Honour proceeded to rule that, in failing to structure the transaction in the most tax-effective fashion, the defendants had not attained the requisite standard of care.[22] The correctness of the outcome in *Hurlingham Estates* is not in issue, but rather the extent to which the comments made in Lightman J's judgment can be generalised beyond the facts of the case.

It is the purpose of the remainder of this article to analyse these two points in the context of lawyers' responsibility to give tax advice generally.

Restriction of scope of the duty of care

Regarding the restriction of the scope of the duty of care in tort via the retainer agreement, Lightman J made the following statement which, due to its significance, must be quoted in full:

> Any such agreement must plainly, if it is to have any legal effect, be clear and unambiguous: *the client must be fully informed as to the limited reliance he may place on his solicitor and the reason for it (ie, the solicitor's lack of any basic knowledge or competence), that this limitation is not a normal term of a solicitor's engagement, and that the client may be better advised to go to another solicitor who is not so handicapped and can be retained with no such limitation on his duties*. Common sense requires that all these matters should also be recorded in an attendance note of the meeting where they are discussed and agreed, and should subsequently be recorded in a letter to the client. The letter is required, not merely to evidence what has been agreed, but to ensure that, after receipt of the letter, the client can consider (and discuss with others) the position and its implications away from, and free from any constraints imposed by, the presence of the solicitor. These are elementary precautions to ensure that the client gives a fully informed consent to a potentially disadvantageous arrangement when there is an obvious potential conflict between the interest of the solicitor (in retaining his client's work) and the client (in obtaining the best, or at least competent, service and advice).[23]

One interpretation of this view is that, if a solicitor perceives that he or she does not have the *present knowledge* to attain the standard of care of a qualified,

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21. Ibid, 263-264.
22. Ibid, 267-268.
23. Ibid, 263 (emphasis added).

competent and careful solicitor *in a particular field of law*, he or she should advise the prospective client to engage another solicitor. This apparently remains the case even though the solicitor in question may be able to meet the requisite standard with respect to some aspects of the matter. Taken at face value, such an approach has broad implications, for Lightman J's statements are not confined to tax advice in the context of general retainers. As legal problems are rarely limited simply to one area of law, there are some grounds for interpreting his Honour's views so as to dictate that solicitors ought, by an express term, to limit the scope of all retainers to those few areas in which they can presently meet the requisite standard of care, and advise clients to seek alternative representation in all cases which may entail an area of law where they *presently* lack the requisite competence.

It is submitted that the key to understanding what Lightman J had in mind lies in the phrase 'ie, the solicitor's lack of *any basic* knowledge or competence' when properly construed in the context of the facts before him. Three factual observations can be made in this regard. First, the solicitor who had the conduct of the matter in *Hurlingham Estates* admitted that he had 'next to no knowledge of tax law and was quite unqualified to give tax advice or to appreciate, or give any warning as to, the existence of any risk of any adverse tax consequences of any transaction, save on the simplest sale of residential property'.[24] Secondly, it would appear that the reason why the solicitor failed to disclose his manifest inexperience of tax law was the fear of losing the retainer.[25] Thirdly, as the solicitor was the defendants' conveyancing and commercial partner, the very nature of his area of practice should have suggested that some tax knowledge was essential.[26]

What these observations indicate is that when Lightman J referred to '*any basic* knowledge or competence', he had in mind a *complete lack* of an understanding of a field of law which, *by virtue of the position occupied by the solicitor in question*, he or she should have had in order to fulfil the requisite standard of care. Any comments by Lightman J which can be construed as stricter than the aforesaid must be viewed in light of the extreme facts of the case and, in particular, his desire to discourage solicitors from undertaking legal work for which they are not sufficiently competent merely for financial gain.

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24. Ibid, 262. This admission was presumably made in aid of the solicitor's ultimately unsuccessful argument that the terms of his retainer did not extend to giving taxation advice.
25. In this context, Lightman J observed, ibid 265: 'I have no doubt that, if [the solicitor] had at the meeting of 29 May exposed his ignorance and unfitness to have the conduct of the matter as he should, the clients ... would have immediately instructed someone competent instead. [The solicitor] must have known and feared this'.
26. Ibid, 262-263.

Viewed in this light, Lightman J's observations are indeed apposite. Importantly, his Honour did not deny that a solicitor may seek the advice of another practitioner or counsel where the solicitor's knowledge is insufficient.[27] What can further be inferred is that, in assessing the level of knowledge necessary to fulfil the standard of care, reference must be made to the complexity or difficulty of the legal problem the subject of the proposed retainer. Lightman J did not discount the notion that, when faced with problems of a relatively simple nature, many solicitors may be able quickly to gain the requisite competence. After all, it cannot be assumed that even those solicitors who specialise in one field of law possess the present knowledge required for *all* aspects of a matter involving that field.

Standard of care

Here it is apt to recall Mr O'Connor's conclusion, cited in the introduction, namely that 'solicitors have a duty to advise their clients on the tax aspects *of whatever matter they are acting in*'.[28] In other words, if Mr O'Connor is correct, solicitors retained to perform any form of transactional work must, in addition to carrying out the mechanics of the transaction or structure in question, do so in the most tax-effective fashion whether or not the client has given an express direction to this end. If this represents an accurate statement of the law, this serves to broaden the scope of the solicitor's retainer and, correspondingly, the scope of the solicitor's duty of care in tort.

A close analysis of this aspect of *Hurlingham Estates* is therefore required. It will be recalled that, having concluded that the retainer agreement in question did not limit the defendants' scope of duty to non-tax matters, Lightman J found the defendants negligent. Specifically, his Honour held that the defendant solicitors 'owed a duty to advise how the transaction should be structured, and to advise that the structure in fact adopted exposed Hurlingham to the tax charge, which ... by alterations to the form rather than the substance of the transaction could have been avoided'.[29] Yet it is Lightman J's statement regarding the appropriate *standard* of care in the circumstances that provides valuable insights into the reach of his decision. The following extract is instructive:

> It is to be expected that an intelligent layman, in the sense of a person unfamiliar with the law of taxation ... would not have imagined that there was any risk of Hurlingham incurring any such liability.... On the other hand, I would expect any

27. On the facts before him, Lightman J, ibid 263, noted the absence of any 'necessary tax law back-up'. Cf *Vulic v Bilinsky* [1983] 2 NSWLR 472, Miles J 483.
28. O'Connor supra n 1, 202 (emphasis added).
29. *Hurlingham Estates* supra n 2, 267.

> reasonably competent solicitor *practising in the field of conveyancing or commercial law to be aware of this concealed trap for the unwary*. It is a matter he should have in mind in any transaction involving the grant of a lease and a related payment by the lessee to the lessor.[30]

Two important limitations appear from the italicised text. First, the standard imposed was that of a solicitor practising in a particular field of law. In other words, because the solicitor practised in the field of conveyancing and commercial law, some tax knowledge could be expected. If this is the case, the converse must also be true: a solicitor practising in another field of law may not be expected to possess the same level of expertise in tax.

This proposition is not without its difficulties. For instance, should a solicitor who specialises in family law carry out a conveyance, the standard of tax knowledge applicable would appear to be lower than if the solicitor specialised in conveyancing. The problem is that, from the point of view of lay clients, many of whom may make an unwarranted assumption that solicitors are competent to deal with *every* area of law, it is difficult to accept that the same standard of advice will constitute negligence in the one case but not in the other.

On the other hand, to suggest that the standard that is applied to a solicitor who advises on nothing but tax law (and is held out as a tax specialist) is no more stringent than that which applies to a solicitor who has a general practice of which tax law may be a part, or who is a tax novice, would seem contrary to common sense.[31] It is also contrary to accepted torts law which dictates that 'a higher level of skill will be demanded from a specialist than a general practitioner'.[32] Hence, there is some basis for the proposition that a solicitor whose practice involves neither conveyancing nor commercial law may be subject to a standard of care less stringent than that which was applied in *Hurlingham Estates*.

There is also the difficulty of the breadth of the phrase 'practising in the field of conveyancing or commercial law'. Take 'commercial law', for example. In addition to tax law, it can encompass the law of contract, property, insurance, trade practices, corporations, associations and partnerships. The list is not exhaustive.

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30. Ibid, 267 (emphasis added).
31. See *Duchess of Argyll v Beuselinck* supra n 16; *Yates Property Corporation v Boland* (1998) Aust Torts Reports ¶ 81-490, Drummond, Sundberg and Finkelstein JJ 65,348-65,349. In the words of an American judge: 'One who holds himself out as specialising and as possessing greater than ordinary knowledge and skill in a particular field will be held to the standard of performance of those who hold themselves out as specialists in that area': see *Walker v Bangs* (1979) 601 P 2d 1279, 1283. Cf *Vulic v Bilinski* supra n 27, Miles J 483; *Klienwort Benson Australia Ltd v Armitage* (unreported) NSW Sup Ct 26 Apr 1989, Cole J.
32. JG Fleming *The Law of Torts* 7th edn (Sydney: Law Book Co, 1987) 99. Although this statement was made in the context of medical practitioners, the principle in question is equally applicable to other professionals.

Even tax law, as a small subset of commercial law, has discrete areas of practice, such as income tax, stamp duty and sales tax. One wonders whether a solicitor practising in general commercial law can really be required to provide tax advice, and more significantly, tax-effective solutions in all cases. To suggest that a retainer involving any of the above separate fields of law would necessarily entail, or be presumed to require, the giving of (often complex) taxation advice would be to set the bar too high.

That Lightman J may not have had this in mind can be inferred from the italicised text above. Note that his Honour stated that he would 'expect any reasonably competent solicitor practising in the field of conveyancing or commercial law to be aware of *this concealed trap for the unwary*'. Critically, his Honour did not say that any reasonably competent solicitor practising in the field of conveyancing or commercial law should be aware of all facets of tax law in all its forms, or even be exceedingly well versed in one part of tax law. The very existence of solicitors who are tax specialists dictates that there are taxation matters of which a 'reasonably competent solicitor practising in the field of conveyancing or commercial law' would be unaware or not be competent to deal with. The reduction of tax liability through schemes involving off-shore entities comes readily to mind as an example. Only those aspects of tax law which relate *directly to the nature of transactions in which a solicitor is held out to be competent* come within the standard of care umbrella. In *Hurlingham Estates*, it was the 'concealed trap' issue, of which such a solicitor should have been aware, simply because this was the type of knowledge that reasonably competent solicitors who advise on such transactions would be conversant with.

There is a further point which must be made regarding the facts in *Hurlingham Estates*. It was accepted in the case that it would have been perfectly legal for the solicitor to structure the transaction in a way that would have avoided the tax liability.[33] It was not a case in which there were several alternatives of uncertain legality. Not all cases are so clear cut. Had there been doubts about the legality or effectiveness of the structure adopted, or as to whether it was ideally suited to the client and the circumstances of the case, the conclusion could well have been different. The reluctance of the courts to find a solicitor negligent for failing to structure a transaction in the most tax-effective way is illustrated by the case of *Bayer v Balkin*.[34] Though this case has (largely because of some misconceived dicta of Cohen J)[35] been touted as raising the solicitors' standard of care to encompass

33. *Hurlingham Estates* supra n 2, 267.
34. (1995) 31 ATR 295. Cohen J's decision has since been affirmed by the NSW Court of Appeal: *Balkin v Peck* (1998) 43 NSWLR 706; (1998) 40 ATR 15.
35. Cohen J said, ibid 305: 'It may once have been considered that it was the duty of citizens and residents of a country to make their proper contribution to the revenue so as to enable

the giving of tax advice, its outcome supports no such proposition. The solicitors of the trust (who were also its trustees), though failing to reduce or avoid a significant tax liability payable by the beneficiaries, were held not to be negligent because Cohen J found that there were disadvantages in adopting a course which would have been more tax-effective and, moreover, to have done so might have been inconsistent with the solicitors' duties as trustees. In *Hurlingham Estates* there were no apparent countervailing considerations which would have justified the approach taken by the solicitors.

CONCLUSION

The foregoing discussion shows that, if the wording of the judgment in *Hurlingham Estates* is scrutinised closely, the decision does not appear to be as broad as at first sight. It does not dictate that solicitors, if not knowledgeable in tax law, must decline any commercial retainer. Nor does it dictate, as Mr O'Connor asserts, that solicitors must advise clients on the tax aspects 'of whatever matter they are acting in'. Such a statement is in terms far broader than the actual ratio of *Hurlingham Estates*. What that case does illustrate is what can be described as a 'maturing' of taxation advice into true legal advice in that it can, *in appropriate circumstances*, come within a general retainer. A warning it is — an all encompassing duty it is not.

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the government to run the country for the benefit of its inhabitants. It now seems to be accepted, with the imposition of high rates of tax upon those who are most able to contribute to that revenue, that there is a duty on persons such as accountants and solicitors to advise their clients how they can avoid, as far as possible, making what the government regards as a proper contribution.' The consternation which this statement caused, both in the tax practitioner community and the Australian Taxation Office, led Cohen J to issue a press release clarifying his comments, to the effect that he was speaking ironically. This saga is discussed by O'Connor supra n 1, 196.