When does limitation begin to run in tax cases?

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The subject of tax avoidance, and HMRC's new powers to recover disputed tax, is rarely out of the headlines at the moment. Since our last alert on the subject in July 2014, at the end of August HMRC began contacting investors with 'accelerated payment notices' (i.e. the notices which require disputed tax to be paid up front by the investor). The notices require the tax to be paid within 90 days. Over 43,000 tax payers will be contacted in total and it is anticipated that somewhere between £4bn and £7bn tax will be sought in this manner.

When does limitation begin to run for negligent acts in cases involving tax? Of course, the Limitation Act 1980 imposes time limits after which claimants will be prevented from pursuing claims. In most negligence cases this will be six years when a negligent act caused loss. There are special rules under s 14A of the Limitation Act, which in simple terms provide that, in causes of action based on negligence, an extension period of three years runs from the claimant's date of knowledge.

These rules have been interpreted by a number of cases since. In the tax field, the following principles have developed.

When is loss suffered?

As above, for the limitation period to commence in negligence a loss must have been suffered. When this occurs is not always obvious in tax cases. The case of *Pegasus* set out some principles, and the Court of Appeal considered when limitation periods commenced in different types of cases:

1. "No transaction" cases – where the claimant would not have entered into the transaction but for the negligence. Here, whether or not loss has been suffered may require a fairly complex factual enquiry. It is necessary to consider the position of the claimant having entered into the transaction, and compare that with his position had he not entered into the transaction, to establish at what stage his or her position was worse off having entered into the transaction.

2. "Wrong transaction" cases – where the claimant would have entered into a different transaction but for the negligence. Here, the position is rather simpler, and the date on which loss is likely to have occurred will usually be the transaction date itself, often giving rise to an earlier limitation period.

It is also worth remarking that, where loss is contingent, as many losses will be in a tax arrangement, the limitation period will not commence until loss is actually suffered.

What about undiscovered problems?

It is the nature of tax problems that they are often not discovered for many years. Consider the middle-aged couple, making provision for the tax treatment of their estate, in circumstances where HMRC will not consider the arrangements until their death – possibly for not many years. The commencement and progression of an HMRC enquiry, and possibly litigation between the estate and HMRC, could take yet further years.

So if the primary 6 year limitation period has expired, in what circumstances can a claimant rely on s14A of the Limitation Act? Claims in negligence can still be made within three years of the date on which a claimant has:

1. The right to bring an action; and
2. Knowledge of the loss alleged to have been suffered; and
3. Knowledge that the loss has been caused by the defendant's negligence.

Because of the complex nature of many tax arrangements, claimants in such cases may rely on this complexity to establish that, whilst they might have known certain facts, they did not have the expertise to gain sufficient knowledge to commence the limitation period. This does not give very much protection to claimants, however, there is clear authority that constructive knowledge will be enough, i.e. the limitation period will commence when it becomes reasonable for a claimant to begin investigating the possibility that negligent advice has been given.

What will be important, then, is when a client realises or should have realised that the tax advice he or she received was negligent and that it has caused him or her a financial loss. Given HMRC's present approach to tax avoidance, the date of knowledge is unlikely to occur on HMRC opening an enquiry: so much is commonplace. Nor is it likely to occur if HMRC denies relief in a closure notice – again, not an unusual outcome, not final, and not necessarily indicative of negligence on the part of an adviser. If the investor accepts that HMRC's analysis is correct (which could be on the date of a closure notice, or earlier) or is advised that HMRC is correct (which could be very early on in any dispute with HMRC) this may be sufficient to commence the limitation period. Otherwise, conceivably, the date of knowledge may not start until some point during any subsequent litigation with HMRC, or indeed the outcome of such litigation.

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