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Engagement Letters: Pre-Nuptial or Post-Traumatic?

Introduction

Whether or not it is addressed expressly in any particular case, a tax adviser's relationship with a client is heavily influenced by law. However, an express agreement between the adviser and the client – typically in an engagement letter – provides the best means for the parties to adjust the legal position to suit their circumstances. A prudent adviser should have an engagement letter in place with every client.

The Context: What the Law Says

The law sets the context for the professional relationship of a tax adviser with a client. It is well established that:

- in undertaking work for a client, a tax adviser owes to the client (in contract and independently in tort[1]) a duty to use the skill and care and to apply the knowledge of (at least) a reasonably competent tax adviser;[2]

1 The law of civil wrongs.

2 *Hurlingham Estates v Wilde & Partners* [1997] STC 627 (UK High Court).

- even if it is not addressed expressly, legislation[3] implies into the adviser's contract with the client terms stipulating that the adviser has the necessary skill to render the service to the client and that the adviser will supply the service with due skill, care and diligence; and
- each of these duties and its scope may be adjusted by agreement between the adviser and the client.

Although it is not yet a settled principle of law, it is likely that a court would demand a heightened standard of care from "a large firm of tax…specialists" who "put themselves forward as providing a top-level specialist service" than in the case of a smaller firm of advisers or a sole practitioner.[4] However, it is important to note that any such adjustment to the adviser's standard of care would be to raise the standard in the case of a large, specialist firm, and not to lower it in the case of a smaller firm or a sole practitioner. This is because, to reiterate, every tax adviser must use the skill and care and apply the knowledge of (at least) a reasonably competent tax adviser, and it is likely that a large, specialist firm of tax advisers must use the skill and care, and apply the knowledge to be expected, of a firm of that scale and degree of claimed specialism.

A Sobering Example

A recent decision in England is especially in point, and it is likely that, on the same facts, an Irish court would reach the same conclusions. It has been held[5] that, when providing CGT advice, a solicitor had been negligent in having failed to give a specific risk warning that a tax-avoidance scheme might fail. The solicitor had not formed and expressed an unsustainable opinion on a tax provision: the court held that a reasonably competent solicitor providing tax advice could indeed have formed the opinion that the particular solicitor had. However, the adviser **had** been negligent in having failed to warn the client that there was a significant risk that, if challenged by HMRC, the tax scheme might fail.

It should be noted that a professional person's "opinion" is precisely that: so long as an opinion is held honestly and reasonably, it is not negligent to express it. This remains so even if the opinion later proves to have been wrong. In part this is because the courts accept the need for professional advisers to "come off the fence" in balanced matters of judgement. However, the courts have also emphasised the adviser's duty to provide the client with full information on the risks of alternative interpretations and of the consequences of any such plausible alternatives applying.

Therefore it is possible for an adviser not to be negligent about the construction of a tax provision yet to be negligent in failing to point out the risks involved in adopting that interpretation. The decided cases note that the precise scope of this obligation is highly fact-sensitive.

Adjusting the Duty of Care

Any adjustment to the legal relationship of the adviser and the client in an engagement letter typically would be:

- by the use of exclusion or limitation clauses (generally drafted to protect the interests of the adviser);
- by broadening the scope of the adviser's duty, to address specific matters that otherwise would be outside the scope (to the advantage of the client); or
- to extend the adviser's duty in the particular engagement to encompass additional parties (such as spouses or shareholders).

3 Sale of Goods and Supply of Services Act 1980, s39.

4 *Altus Group (UK) Ltd v Baker Tilly Tax and Advisory Services LLP* [2015] EWHC 12 (Ch); [2015] STC 788 (UK High Court).

5 *Barker v Baxendale Walker Solicitors (a firm)* [2017] EWCA Civ 2056; [2018] STC 310 (UK Court of Appeal).

Prudence and Practicality

Although "an audit engagement letter or other suitable form of written agreement" is mandatory in the case of an appointment of a statutory auditor under the Companies Act 2014,[6] there is no such requirement in respect of a tax engagement. Nonetheless, both prudence and professional sense suggest the merit of documenting the terms of the tax adviser's role with every client.

An engagement letter also offers the adviser the opportunity to document clearly some practical matters that will be material to the engagement. This reduces the scope for disputes to arise based on misunderstandings or inadequate communication. As with most things in business, things work most efficiently when it is clear what is expected, of whom, by when and for how much.

Tax Advice in the Context of Other Services

Other legal considerations may arise where tax advice is combined with other advice or services. Most obviously, an auditor may be restricted or prohibited from providing such non-audit services to public-interest entities,[7] and in any event an audited company must disclose fees that it has paid to its statutory auditor for tax advisory services.[8]

An adviser should be especially alert when providing tax advice as part of any such bundle of services. For example (as is considered further below), where the tax advice is being provided by a company's statutory auditor, neither the constitution of the client company nor any contract may exempt the statutory auditor from liability for "any negligence, default, breach of duty or breach of trust" in relation to the company.[9] The same provision prohibits the client company indemnifying the statutory auditor in respect of any such liability.

What an Engagement Letter Ought to Include

Reflected in the Irish Tax Institute's "Outline of Broad Provisions to Include in a Letter of Engagement" (which the Institute emphasises is not to be regarded as a pro forma template), an engagement letter might be expected to address at least the following matters. Of course, other issues may arise in specific transactions or engagements, and an adviser should consider these specifically in each case.

Parties

In identifying who the parties are, the tax adviser and the client also are defining the scope of the adviser's duty of care and whether (for example) it is owed only to the client or is extended to (say) additional named people or to a class of people connected with the client (such as co-investors, a parent or other group company, a spouse, a person's children, etc.). Where the adviser accepts that the advice may be shown to a person who is not a Party, the engagement letter should state that the third party may be shown the advice only on a non-reliance basis.

Period of engagement

If the engagement is for a specific task, transaction or project, it may be appropriate to specify only the start date (which would be read with the project definition); or, if the adviser is being retained generally, an express end date may also be appropriate.

Scope of the services

What precisely is the adviser expected to do (what are to be the deliverables?), and is the adviser's performance to be subject to any "milestones"? For example, is the service to be advisory only, or is it to be both advisory and compliance in nature? Does the engagement relate to specific tax head(s) or to specific tax

6 International Standard on Auditing (Ireland) 210 ("Agreeing the Terms of Audit Engagements"), paras 10, 16, A22 to A24 and Appendix 1.

7 Regulation (EU) No 537/2014 on specific requirements regarding statutory audit of public-interest entities, Articles 4(2), 5, 10(2)(f), 13(2)(k) and 14; Companies Act 2014, s1550.

8 Companies Act 2014, s322(2) and (3).

9 Companies Act 2014, s235.

year(s) only; if so, what is to be the adviser's role if, in the course of the work, issues arise that have implications for other tax heads/ years? The letter should set out whether the client or the adviser is to perform the client's filing obligations.

Tax adviser's responsibilities

The adviser may wish to state expressly the standard of care that it will adopt and set out who in the adviser's firm will provide the advice or will coordinate the advisory team. It also should mention that the engagement may entail the disclosure of information regarding the client to regulatory authorities. This includes the obligation on a tax adviser to report to the directors of a client company (and, if they do not take remedial action within the stipulated six months, to the Revenue Commissioners) where through an engagement with the company the adviser becomes aware that the client company has committed, or is in the course of committing, one or more relevant tax offences.[10]

It also would be prudent to make clear that any such disclosure obligation is the adviser's, and so (for example) the client cannot choose to waive disclosure by the adviser. Also, the adviser may wish to prohibit the client using the advice for any purpose other than the specific transaction or project to which the engagement relates (see "Intellectual Property", below).

Client's responsibilities

Drawing on the "Scope of the Services", it would be prudent to allocate responsibility for filing returns and paying tax that may be due and the date(s) by which each step must be taken and to highlight the potential for interest and penalties to apply in the event of default.

The engagement letter should also emphasise that the client must make full and true disclosure to the adviser of all information that is relevant to the engagement. Although in the case of an audit of a company such proactive disclosure of information by directors to the statutory auditors is mandatory,[11] in the case of tax advisory work any such obligation on the client must come from contract (through the engagement letter).

Fees and billing

The engagement letter should set out clearly the basis of charge and liability for any incidental expenses, the frequency of any interim billing and the treatment of VAT. It is possible that the client may withdraw instructions or that the relevant legislation may change before the matter is completed or the advice is provided, and the engagement letter should set out the basis of charge in any such event.

Limitation of liability

The adviser should emphasise that he or she is advising only the "Parties" and not any other person, whether or not the advice is communicated to such a third party. Indeed, the adviser should consider prohibiting the client communicating the advice to any person other than a Party. The adviser might also consider limiting liability for negligence and breach of contract to a specified amount or to (say) some multiple of the fees that will be due under the contract or to the limit of the adviser's professional indemnity insurance. Of course, a client may resist such a proposed limitation, and whether it is ultimately accepted will be a matter of commercial negotiation.

In any event, where a statutory auditor is providing tax advisory services, it will be recalled (see "Tax Advice in the Context of Other Services") that neither the constitution of the client company nor any contract may exempt the statutory auditor from liability for

10 Taxes Consolidation Act 1997, s1079. For these purposes a "relevant person" includes a person who "with a view to reward, assists or advises the company in the preparation or delivery of any information, declaration, return, records, accounts or other document which he or she knows will be or is likely to be used for any purpose of tax...".

11 Companies Act 2014, s330.

"any negligence, default, breach of duty or breach of trust" in relation to the company, nor may the client company indemnify the statutory auditor in respect of any such liability.

Intellectual property rights

It is important to clarify whether the adviser will retain or the client will receive the intellectual property in the advice or other deliverable. Of course, in either event each of the Parties must be entitled to use the advice for the purposes for which it has been procured from the adviser.

Ownership of working papers

The engagement letter should make clear whether the adviser or the client owns the adviser's working papers, ownership of the physical and digital materials often being distinct from the intellectual property in the advice that the adviser formulates.

Data protection

For legal purposes,[12] it is important that the adviser sets out clearly the legal bases on which and the purposes for which he or she will hold and process the client's personal data. Data protection requirements should also influence the adviser's document retention and destruction policy.

Retention of records

It would be prudent to remind the client of the length of time for which the client must maintain tax records. The letter should also set out the adviser's document retention and destruction policy; although in doing so the adviser would adopt an obligation to maintain the records for at least that specified period of time, it also would make clear to the client the adviser's entitlement to destroy the adviser's papers relating to this client engagements when that period of time has expired.

A tax adviser's document retention and destruction policy on which such a clause would draw must be prepared carefully in the context of statutory limitation periods, data protection requirements and statutory document retention obligations.

Confirming Acceptance

A client's acceptance of the terms of a letter of engagement is a matter of evidence. Therefore it is not critical that a client physically signs a copy of the letter and returns it to the adviser. However, such a signed copy would, of course, be the best evidence that the client has in fact accepted the terms, and so that is the prudent approach for the adviser to adopt.

Nonetheless, a client's acceptance can be demonstrated by (for further example) an email from the client stating that the client accepts the terms of the engagement letter (and preferably making reference to its date, to avoid any ambiguity). Although in the event of a dispute, acceptance by the client could be proved from performance of the contract by the adviser and the client, such a need should be avoided by having the client accept the engagement letter formally by clear and unambiguous means, such as a physical signature or email confirmation referring clearly to the particular letter and accepting it expressly.

Irrespective of the manner in which the client confirms acceptance of the terms of the engagement letter, the adviser should not normally commence work on the engagement prior to the client's acceptance.

Revisit Letters of Engagement

When a letter of engagement has been agreed for an ongoing relationship or for retained advice, it is prudent to revisit that letter at least annually to ensure that it remains appropriate for its intended purposes: for example,

12 Regulation (EU) 2016/679 (the General Data Protection Regulation) and the Data Protection Act 2018.

legislation or the client's circumstances may have changed in ways that are relevant to the scope of services or to the challenge or difficulty in providing those services.

Conclusion

A well-crafted and up-to-date letter of engagement is likely to contribute to a more successful client engagement by reducing the scope for misunderstandings and disappointed expectations. Also, to reiterate, things in business tend to work most efficiently when it is clear what is expected, of whom, by when and for how much. However, ultimately and most significantly, an engagement letter should be seen as an important part of the tax adviser's risk-management toolkit.

Read more on taxfind From Irish Tax Institute *Altus Group (UK) Ltd v Baker Tilly Tax and Advisory Services LLP* [2015] EWHC 12 (Ch); [2015] STC 788 (UK High Court); *Barker v Baxendale Walker Solicitors (a firm)* [2017] EWCA Civ 2056; [2018] STC 310 (UK Court of Appeal)

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