

PROFESSIONAL INDEMNITY INSURANCE (PII)

GUIDANCE NOTES FOR MEMBERS OF THE CIOT AND ATT

1. HOW MUCH PII COVER SHOULD I HAVE?

The minimum levels of cover are set out in paragraph 5 of the regulations. They are £1 million for each and every claim unless your firm's gross fee income is less than £400,000 in which case it is the greater of 2.5 x gross fee income or £100,000. Gross fee income is defined in the regulations and discussed at 2 below.

It is essential that you carry out a risk assessment before deciding the level of your firm's PII cover rather than simply opt for the minimum. Points to take into consideration include:

- The risk profile of the work you carry out for your clients – is it routine work involving comparatively small sums or is it complex and aggressive tax planning likely to be challenged by the tax authorities?
- What resources are available to the firm to meet any claims in excess of the insured amount?
- Remember you can insure a specific project if necessary where, for example, the tax involved is in excess of your existing PII cover.
- Does your firm have effective systems and controls in place to minimise the risk of a claim arising out of administrative failures? Are these procedures kept under regular review? Lawyers dealing with tax-related PII claims suggest that most claims arise as a result of basic errors such as failure to meet deadlines or missing the time limit for a claim.

The CIOT and ATT recommend that members should have cover of £1,000,000.

2. GROSS FEE INCOME – HOW IS IT CALCULATED?

Gross fee income is defined in the PII regulations as

'the aggregate of professional fees and all other income (including commissions) earned in respect of and in the course of business during the accounting year immediately preceding the year in question, but excluding any commission passed on to the client in full, and which is not retained to offset against fees.'

In your first year in practice an estimate of your gross fee income should be used. Equally if the most recent set of accounts are not for a full year you may need to use an estimate.

It is advisable to notify your insurer of any major changes which take place in your firm, for example an acquisition or a demerger so that the insurer can ensure that your PII continues to provide adequate cover for the changed circumstances.

Fees received in respect of work subcontracted to others must be included in gross fee income unless the work is clearly shown as a disbursement and the client knows that the member's firm is not taking professional responsibility for this work.

3. I AM AN EMPLOYEE – DO I NEED PII COVER?

Subject to the exceptions below, as an employee you should be protected by your employer's PII policy or other insurance arrangements. This is the case whether you are working in industry or in the tax/accounting profession. However if:

- you provide taxation services in a capacity other than as an employee. For example, in the evenings and weekends you prepare tax returns and offer tax advice to a handful of clients (including family and friends). There is no connection with or any involvement from your employer. In those circumstances you will need PII cover unless it is done on a pro bono or honorary basis. See also the guidance below on pro bono and honorary work.
- you are a director or an employee and you have a financial interest which represents 5% or more of the equity capital in your employer's taxation services firm you will need to ensure that your firm has PII cover which complies with the CIOT/ATT regulations.

4. HONORARIA AND PRO BONO WORK

In the PII regulations honorarium is defined as 'a fee paid in respect of a formal honorary post for charities, amateur organisations and other not for profit organisations'. Pro bono is defined as 'work for which absolutely no payment is made in cash or kind'.

The important point to bear in mind when you give advice for which you do not charge or charge a greatly reduced fee is that a claim can still be made against you if the advice you give is defective. To determine whether a case against you will succeed the court will ask the following questions

- Was a duty of care owed to the client?
- Has that duty of care been breached?
- Was the breach causative of loss?

If the answer to all three questions is yes the claim will succeed irrespective of the size of the fee charged.

If you are a sole practitioner or partner in a firm pro bono advice/honorary work may in some circumstances be covered by your/the firm's PII's policy. For example if you give free advice to a local charity in order to raise your practice's profile in the local area that may be covered. However, free advice given to your neighbour in the pub is much less likely to be covered.

If you are an employee and give pro bono advice or undertake honorary work the first step is to check your employment contract to establish whether it prohibits you from carrying out such work. If you give advice outside the terms of your contract of employment it is unlikely you will be covered by your employer's PII policy. If such work is permitted under your contract of employment you may be covered by your employer's policy but cover will depend on a number of factors including whether you were acting as an employee or as a member of the public.

If you are not covered by your employer's policy and you make a mistake there is a real risk that a claim could be made against you personally. Therefore if you are giving advice on a pro bono/honorary basis you should consider carefully the need for PII cover in case of claims.

In any event under the PII regulations if you provide taxation services on an honorary or pro bono basis and do not have PII cover you are obliged to notify your client of this fact in writing.

Remember you can be sued for honorary and pro bono work if the advice given later proves to have been defective.

5. CONSULTANTS AND SUBCONTRACTORS

A consultant may be sued for negligent advice and a claim may be brought against the firm for which he is working and/or against the consultant.

A member who works on a self-employed basis as a consultant for a firm which provides taxation services must have PII cover unless he has confirmation from the contracting firm that their policy complies with the CIOT and ATT PII regulations and covers him in his capacity as a self employed consultant (as not all policies will do so).

Some members provide taxation services on a self-employed subcontract/consultancy basis to businesses which are not themselves a provider of taxation services (for example, members who work in the taxation departments of large companies). The business using the services of the member is unlikely to have relevant insurance which would cover the member and which would comply with the CIOT and ATT PII regulations. A member in these circumstances must take out his own PII which does comply. However, it is open to that member to apply to the CIOT or the ATT for an exemption from the need to have PII cover if he has written assurance that the business contracting with him will not make a claim against him. Notwithstanding this, members should be aware that the CIOT and ATT strongly recommend that members should hold their own PII policy in such circumstances.

6. DOES MY POLICY COMPLY WITH THE PII REGULATIONS?

The following notes identify some of the less obvious requirements of a PII policy if it is to comply with the PII regulations.

Each and every claim

A member's PII policy must be on an 'each and every' claim basis.

A PII policy can effectively be on an 'aggregate' basis or an 'each and every' claim basis. In broad terms 'aggregate' means that for a £1m policy the maximum the insurer will pay out is £1m whether it is made up of several smaller claims or one large claim. With an 'each and every' basis policy the insurer will pay out up to £1m for each claim made during the lifetime of the policy. The 'each and every' basis is the industry norm for professionals such as tax advisers and taxation technicians and it affords greater protection to the member and his clients.

Civil liability

Under regulation 4.1b a member's PII policy must cover 'all civil liability'.

Not all insurance policies cover claims for civil liability. Examples of civil liability include claims which are made solely in contract and not in negligence. Some policies cover claims arising out of negligence but only some elements of a claim in contract. However, claims can be made in both negligence and/or contract and the damages payable may differ.

Example

A tax adviser may have a contract with a client in which he agrees to perform certain work within a timescale and agrees to pay penalties if the timescale is not met. The tax adviser carries out the work incompetently and late. The incompetence causes loss to the client but his tardiness does not.

The sums payable under the penalty clause in the contract would not be covered under a negligence only policy. This is because the cost of the penalties would constitute a claim in contract.

The loss arising from the incompetence is both a liability in negligence and contract and would be covered by both a policy covering negligence claims and one covering civil liability claims.

A policy that only covers you for negligence may not protect against all elements of a claim for breach of contract. Therefore it is advisable to ask your broker to ensure that your PII policy covers against all civil claims and not just claims in negligence.

Is the cover 'costs inclusive' or 'costs in addition'?

Cover can be provided with 'costs inclusive' where the costs of defending a claim are included within the limit of indemnity (ie for a policy with £1m cover the maximum amount paid out would be £1m) or 'costs in addition' where the costs are paid in addition to the limit of indemnity (ie for a £1m cover policy the maximum payout would be £1m **plus** costs).

To comply with the CIOT and ATT PII regulations cover must be, as a minimum, on a 'costs inclusive' basis. However members should be aware that 'costs in addition' provides greater protection and should give careful consideration to taking out a policy on a 'costs in addition' basis.

Misrepresentation or non disclosure

Regulation 4.1d requires that the policy (save for sole practitioners where such cover is not available) is 'not avoidable by reason of any misrepresentation or non disclosure or any other act or default of the insured'. Typically this cover is conditional upon it being shown that the misrepresentation, non disclosure or any other default was innocent and free from any intent to deceive and cover on this basis is acceptable.

To ensure that your policy fully complies with the PII rules it is advisable to provide your broker with a copy of the rules when you ask him to obtain quotes for PII cover.

7. TAX IS ONLY AN INCIDENTAL PART OF MY WORK – DO I NEED PII?

Where a member works in a role which is predominantly non tax related but from time to time he gives tax advice it is not always clear cut whether the member needs to have PII. **However, the starting point is always that if you hold yourself out as a member of the CIOT or the ATT and you provide taxation services, no matter how small, you must have PII.**

The illustrations below set out some of the more common situations. They are intended as guidance only; if you are uncertain whether you need PII or not you should contact the CIOT or the ATT for further guidance (see 13 below for contact details).

Illustration 1

Adam is an ATT who is also a director and 25% shareholder of a wine importing company. From time to time he gives tax advice to his fellow directors on business transactions but his main role within the company is to maintain and develop relationships with customers and wine producers. For more complex tax matters the company consults its external tax advisers. Adam wonders whether he is required to have PII under the CIOT regulations.

Adam is not obliged to have PII cover as the company of which he is a director/ shareholder is not a provider of taxation services **and** when giving tax advice Adam makes it clear to his fellow directors that he is acting in his capacity as a director of the company and not as an ATT. He is not holding himself out to third parties as an ATT.

Illustration 2

Brian is a CTA who is also a self-employed management consultant. He feels he has the edge on many of his competitors in that he can give advice on tax matters as well as the usual management consultancy matters. He uses this as a selling point when meeting prospective clients and his tax qualification is included on his business card. However, in practice the tax element of his work is very small – typically less than 10% of his time spent on a project will be concerned with tax. Brian does not think he needs PII.

The basic rule is that where a member offers tax advice ‘as a chartered tax adviser or as a taxation technician, with the intention that another person, body or organisation should rely on such services’ (see regulation 1.10) he is required to have PII. Although Brian is predominantly a management consultant his promotion of his membership of the CIOT and his tax knowledge to win business is likely to lead clients to believe that he is giving tax advice as a CTA and as such he must have PII. In any event, irrespective of the CIOT PII requirements Brian would be well advised to have PII to cover all aspects of his management consultancy practice.

8. FIDELITY GUARANTEE INSURANCE – DO I NEED IT?

Fidelity guarantee insurance provides cover against any acts of fraud or dishonesty by any partner, director or employee in respect of any money or property held in trust by the firm. Whilst it is not compulsory for members in practice to take out such cover it is recommended as best practice.

9. WHAT LEVEL OF EXCESS MAY I HAVE?

The regulations allow the PII policy to include an excess of up to £20,000 per principal. For the protection of clients, the public and members themselves the regulations require that when determining the appropriate level of excess the firm must be satisfied that it could meet the excess element of any claim which might arise.

As a general rule the higher the excess the lower the premium. Insurers tend to see insured persons with higher excesses as being more likely to have an interest in good risk management as it affects them in the pocket each time they get it wrong. There is obviously greater motivation to avoid a claim if you are bearing say the first £5,000 than if a similar claim will, initially at least, only cost you £500.

Equally, for policies with a higher excess the insurer will not be called upon to deal with time consuming small claims which tend to cost proportionately more to manage than the larger but generally less frequent claims.

You can therefore minimise the cost of premiums by increasing the excess payable on your policy, subject of course to the overriding requirement that the excess is at a manageable level for your firm and within the CIOT and ATT limits. It is not acceptable to opt for a higher excess to reduce the premium payable unless you are confident of your firm's ability to meet its liabilities under any claims which arise.

If your firm has subsidiaries or associated firms and you have a group PII policy the excess may be calculated on a group basis.

10. LIABILITY CAPPING

Some firms include a clause in their engagement letter which seeks to cap the firm's liability to its client in the event of a claim being made. This may be effective in many instances and it is a reasonable step to take to minimise liability. It may also reduce the premium payable as insurers regard liability capping as an indicator of good risk management by the insured. However, it would be unwise to rely wholly on a liability cap as being effective in every case. There are a number of issues which you should take into account when considering liability caps.

- **No engagement letter**

It may seem obvious but the liability cap will not be effective if there is no engagement letter in place. It is best practice to have engagement letters but sometimes the system falls down, for example, the engagement letter is not returned by the client, the costs of drawing up an engagement letter for a one off assignment were considered to be out of all proportion to the fee which could be charged for the work undertaken or it was a very rushed job and

there simply wasn't time to draw up the engagement letter. Without the engagement letter it is most unlikely that the liability would be capped.

- **Work not covered by the engagement letter**
A client may engage a member to carry out work which is not covered by the engagement letter. For example, a compliance client asks for advice on trusts. It so happens that your firm employs a trust specialist who has a meeting with the client and follows it with a meeting note. The existing engagement letter does not cover the work undertaken and a new engagement letter was not drawn up. In those circumstances it is most unlikely that the liability would be capped.
- **Claim made by a third party**
The liability cap included in the engagement letter would not extend to claims made by third parties. For example, you may give tax planning advice to a company on a corporate transaction and have an engagement letter (with a liability cap) signed by the directors on behalf of the company. However, the advice that you give could impact on the personal tax position of the shareholders (whom you were aware of and who you knew would rely on the advice and who took part in the transaction). If the advice that you give is wrong and has a detrimental effect on the shareholders you could face a claim from them. Any such claim would not be subject to the liability cap as they were not signatories to the engagement letter.
- **Liability cap rejected by the courts**
It is possible that the courts could consider the liability cap to be unreasonable condition and as such unenforceable.

11. I CANNOT GET PII COVER – WHAT SHOULD I DO?

If you are unable to obtain cover you should apply to the CIOT or the ATT under regulation 3.1 setting out the steps you have taken to obtain cover and the reasons why cover has been refused. Your application will be considered and you will be advised of the outcome within 30 days. Where exceptionally it is not possible to meet this deadline you will be kept informed of progress and delays will be kept to a minimum.

12. APPEALS IN RESPECT OF APPLICATIONS FOR AN EXEMPTION OR EXCEPTION

If you apply for an exemption under regulation 3.1 and you are unhappy with the outcome you may submit an appeal to the Taxation Disciplinary Boards Limited within 30 days of the date of the notice advising you of the decision of the CIOT or the ATT. Appeals should be addressed to The Secretary, The Taxation Disciplinary Board Limited, 12 Upper Belgrave Street, London, SW1X 8BB.

13. WHO SHOULD I CONTACT IF I HAVE ANY QUERIES ABOUT THE PII REGULATIONS?

You should contact the Deputy Secretary (Jonathan Crump - jcrump@ciot.org.uk) at the CIOT or the Secretary (Andrew Pickering- apickering@att.org.uk) at the ATT.

