Tax Engagement Letter's Liability Limit Upheld

In *Felty v. Ernst & Young LLP* (**2015 BCCA 445**), a decision of the Court of Appeal of British Columbia, an engagement letter's limitation of malpractice liability to the amount of the fees charged was held to be enforceable. Although the transaction in question resulted in a US tax liability of more than US$540,000 that the taxpayer had not been warned about, the adviser's professional liability was limited to about $15,000; the court did not determine what the liability would have been in the absence of the clause. In light of this decision, advisers who are not currently including strong liability limitations in engagement letters might wish to begin doing so in jurisdictions where provincial legislation does not prohibit this practice.

In *Felty*, the taxpayer's lawyer sought advice from an accounting firm about the US tax consequences of a transfer of shares as part of a proposed divorce settlement. The firm's US affiliate incorrectly advised that the transfer created no US tax liability. (Negligence was effectively admitted by the firm at trial.)

The tax engagement agreement limited professional liability to the amount of fees charged, a provision that is perhaps at the more restrictive end of such limitations. The taxpayer argued on appeal that the courts should decline to enforce the limitation-of-liability clause on the grounds of public policy because professionals should be held to a high degree of diligence. (The trial judge had ruled [**2013 BCSC 815**] that the limitation-of-liability provision was not unenforceable on grounds of unconscionability, but this point was not challenged on appeal.) The BCCA rejected the public policy argument, concluding that it is largely confined to cases that are "compelling," such as the manufacturing of baby formula with a toxic compound, or "reckless," such as the knowing provision of defective material to be used in natural gas pipelines. Overall, the court concluded (quoting from *Loychuk v. Cougar Mountain Adventures Ltd.*, **2012 BCCA 122**):

I am not persuaded that an error in the giving of erroneous tax advice in the circumstances of this case rises to the level that is "so reprehensible that it would be contrary to the public interest to allow [the defendant] to avoid liability."

The court in *Felty* noted that although British Columbia's Legal Profession Act (SBC 1998, c. 9) prohibits lawyers from limiting their liability for negligence, a similar standard does not exist in the Chartered Professional Accountants Act (SBC 2015, c. 1). A similar distinction between lawyers and accountants applies in Ontario. Section 22(1) of the Solicitor Act (RSO 1990, c. S-5) states that "[a] provision in any such agreement that the solicitor is not to be liable for negligence or that he or she is to be relieved from any responsibility to which he or she would otherwise be subject as such solicitor is wholly void." In contrast, CPA Ontario confirms that the Chartered Accountants Act, 2010 (SO 2010, c. 6, schedule C) and CPA Ontario's bylaws, regulations, and rules are silent on this point. (In 2014, when CPA Ontario and CGA Ontario signed their unification agreement, they requested a new Chartered Professional Accountants Act from the province as soon as possible; however, no new act has yet been released.)

If a limitation-of-liability clause is included in an engagement letter, the client may push back

and decide to engage another tax adviser who would agree to omit such a clause. Each situation may have to be examined on its own merits, and a client who wants to omit a limitation-of-liability clause may have to pay higher fees to compensate for the increased risk and the need to document all uncertainties in the work done for the client. Some advisers feel that a limitation of liability to the amount of the fees charged may be counter-productively strict, and may cause a client to feel aggrieved enough by the lack of compensation to sue the adviser in the event of an unfavourable outcome in a dispute.

Jamie Herman and Tracy Wu
Hennick Herman LLP
Richmond Hill, ON
jaherman@hh-llp.ca
twu@hh-llp.ca

Canadian Tax Focus
Volume 6, Number 1, February 2016