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PROFESSIONAL LIABILITY BLOG

When Preparing Tax Returns Equals an Illegal Recommendation to Utilize Tax Shelters: The Limits of Professional Liability Coverage

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Introduction

Concurrent causation can be a tricky doctrine to apply, but nonetheless is important in determining whether professional liability insurance will cover a claim. Generally speaking, concurrent causation mandates coverage if two causes—one covered by a policy, the other excluded by a policy—contribute to a loss. But, this simple formulation is not as straightforward as it first appears, as was recently demonstrated in the case of Financial Strategy Group, PLC v. Continental Cas. Co., 2015 WL 4635783 (6th Cir. 2015).

Facts

Financial Strategy Group (FSG) prepares tax returns. In 2008, FSG purchased professional liability insurance to cover claims arising from its tax-preparation services. The policy notably excluded claims “based on, arising out of, or in connection with the design, recommendation, referral, sale, or promotion of illegal tax shelters.” Id. at *1. Soon after purchasing insurance, FSG was sued by several clients for malpractice and fraud. The clients claimed that FSG had conspired with other tax advisors to develop, promote, sell, and implement “investment strategies” that the IRS later determined were illegal tax shelters. Id. FSG submitted these claims to its insurer, which promptly denied them on the ground that the policy excluded claims involving recommendations to use tax shelters. Id.

The Legal Issue

FSG argued the denial of coverage was wrongful because much of its conduct was covered by the policy as actions constituting the preparation of taxes; said differently, FSG argued it did not design, recommend, or sell illegal tax shelters because it prepared tax returns for its clients after the shelters had already been designed, marketed, and sold. Id. at *2.

The Court's Analysis

The Sixth Circuit disagreed with FSG, emphasizing the term "recommendation" in the policy's exclusions. According to the court, FSG's act of preparing taxes for its clients with a proposed loss for the illegal tax shelters was an act amounting to recommending to proceed with them (effectively suggesting to its clients that the tax shelters were viable deductions). Id. Moreover, by advising its clients to sign and file the tax returns, after having explained that the tax returns were "prepared in accordance with professional standards and pursuant to the IRS guidelines," FSG was directly recommending the clients' use of the illegal tax shelters—causing such conduct to fall directly into the policy's exclusion. Id.

FSG argued the doctrine of concurrent causation saved its claims from exclusion because the act of recommending the use of a tax shelter was independent of FSG's preparation of the tax returns generally. The court was unpersuaded, stating "that distinction is illusory." Id. at *3. Because the clients' complaint alleged the tax-preparation activities of FSG were used as the driving force to recommend an illegal tax shelter, the concurrent causation doctrine did not apply: tax preparation was part and parcel with the recommendation to use illegal tax shelters, defeating any notion that two distinctive causes of injury existed. Id.

Practical Takeaway

The doctrine of concurrent causation should be carefully considered. It is not always true that two acts—one covered, the other excluded—automatically result in coverage. At times, the acts may not be sufficiently independent and, as such, coverage is excluded to the surprise of the insured. For this reason, an insured should carefully consider how his or her professional service interrelates with the exclusions found in his or her policy.

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