



**Paper**

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**Levelling the playing field – the options for  
reforming protection for tax advice in the  
United Kingdom: lessons from other  
jurisdictions**

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## LEVELLING THE PLAYING FIELD – THE OPTIONS FOR REFORMING PROTECTION FOR TAX ADVICE IN THE UNITED KINGDOM: LESSONS FROM OTHER JURISDICTIONS

### SUMMARY

*The United Kingdom (UK) is typical of many common law jurisdictions at present, in that the revenue authority (HM Revenue and Customs ) has extensive powers in Schedule 36 of the Finance Act 2008 (Schedule 36) to inspect buildings and obtain information coercively, with one of the significant constraints on this power being the right of a legal adviser or client to claim the protection of the doctrine of legal professional privilege (LPP) in appropriate cases under paragraph 20 of Schedule 36.*

*Unfortunately, this does not assist accountants and other non-lawyer tax advisers, because the recent UK Court of Appeal case of R (on the application of Prudential Plc) v Special Commissioners of Income Tax [2010] EWCA 1094 (Prudential (CA)) has confirmed that the protection of LPP is limited to tax advice provided by lawyers and does not apply to (the same ) tax advice when given by accountants or other tax advisers, though there appears to be a developing groundswell of support for such an extension. Indeed, Lloyd LJ, in his concluding comments in Prudential (CA), stated that while he agreed with the observation by Charles J in the High Court - that it was “not easy to see” why the logic underpinning LPP should not also support the application of a similar privilege to accountants and other tax advisers who were not legally qualified – in his Honour’s view, it was not for the courts to extend the scope of LPP to non-lawyers, as this could only be done by Parliament.*

*While paragraph 20 of Schedule 36 applies the full protection of LPP to tax advice from lawyers, paragraph 25 (Schedule 36) provides only very limited protection when the same advice is given by tax advisers who are not lawyers. This substantial disparity in the level of protection for the very same tax advice - which is based solely on the status of the advice giver - creates an uneven playing field between the legal and accounting (and other) professions.*

*This differential protection has been characterised as an “unfair penalty” on those seeking tax advice from an accountant rather than a lawyer<sup>1</sup> and has created direct competition and sometime tensions<sup>2</sup> between the professions. It could in some cases cause a client to choose a lawyer rather than an accountant for advice on tax issues.*

*Accordingly, the authors believe it may be timely for the UK and other jurisdictions to consider introducing legislation to “even out” the protection for advice from accounting and other non-legal tax advisers. This process could draw guidance from the approaches taken in the two foreign jurisdictions referred to in Prudential (CA) – New Zealand and the United States - as well as proposals currently under consideration in Australia.*

*This Paper seeks to analyse the pros and cons of these alternative systems, and to draw out some possible guidelines which might assist other jurisdictions to develop an appropriate system. For convenience, comparisons have been drawn with the UK system, but the insights gained are generalisable.*

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<sup>1</sup> K Kendall, “The US tax adviser’s privilege: insights for Australia”, (2010) 25 ATF, 361 at 386 (footnote 163]

<sup>2</sup> Kendall, above fn 1, at 379.

## 1. INTRODUCTION AND OVERVIEW

The common law doctrine of legal professional privilege (LPP) protects communications between legal advisers<sup>3</sup> and their clients from compulsory disclosure to tax officers and others under provisions such as Schedule 36 of the *Finance Act 2008* (FA 2008) (Schedule 36).

Lord Hoffman summarised the rationale underlying LPP and its importance in *R v A Special Commissioner, ex parte Morgan Grenfell & Co Ltd*<sup>4</sup> (*Morgan Grenfell*) as:<sup>5</sup>

“LPP is a fundamental human right long established in the common law. It is a necessary corollary of the right of any person to obtain skilled advice about the law. Such advice cannot be effectively obtained unless the client is able to put all the facts before the adviser without fear that they may afterwards be disclosed and used to his prejudice... it has been held by the European Court of Human Rights to be part of privacy guaranteed by Article 8 of the Convention... and held by the European Court of Justice to be a part of Community law...”

Traditionally there are two limbs of LPP identified:

- (i) legal advice privilege and
- (ii) litigation privilege.

Legal advice privilege<sup>6</sup> protects “communications undertaken for the purposes of a lawyer giving advice to his client.” The second type of privilege – litigation privilege - protects all communications undertaken for the dominant purpose of furthering litigation and – significantly - does “not necessarily involve a client-lawyer relationship.”<sup>7</sup>

In the United Kingdom (UK), LPP (more particularly legal advice privilege) is specifically recognised in the tax context in Schedule 36 (paragraph 23) and its predecessor, section 20 of the Taxes Management Act (TMA) 1994.<sup>8</sup>

The common law courts have consistently resisted extending LPP to professions other than lawyers, with the UK Court of Appeal in *R (on the application of Prudential Plc) v Special Commissioners of Income Tax (Prudential (CA))*<sup>9</sup> confirming in 2010 that legal advice privilege does not apply to accountants - indeed, Lloyd LJ, in his concluding comments in *Prudential (CA)*, stated that to make LPP available to professional advisers other than lawyers would require statutory intervention – such as his Honour observed<sup>10</sup> had occurred in New Zealand (NZ) and the United States (US).<sup>11</sup>

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<sup>3</sup> In this article the reference to lawyers (in the context of privilege) refers to both solicitors and barristers.

<sup>4</sup> *R v A Special Commissioner, ex parte Morgan Grenfell & Co Ltd* [2002] UKHL 21; [2002] STC 786.

<sup>5</sup> *Morgan Grenfell*, above fn. 4, [2002] UKHL 21 at [7].

<sup>6</sup> D. Dixon, “Legal Professional Privilege and Advice from Non-lawyers” [2010] BTR 83 at 84.

<sup>7</sup> Dixon, above fn. 6, at 84.

<sup>8</sup> It was established in *Morgan Grenfell* that a notice under s 20 TMA did not require a person to disclose documents to which LPP applied.

<sup>9</sup> *R (on the application of Prudential Plc) v Special Commissioners of Income Tax* [2010] EWCA 1094.

<sup>10</sup> *Prudential (CA)*, above fn 9, [2010] EWCA 1094 at [80], [84].

<sup>11</sup> I. Higgins, “Recent developments in the law of privilege” (2011) 26(4) JIBLR 188 at 191; cf Lloyd LJ in *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [2].

The courts have taken this approach even though it is now widely acknowledged that accountants and other advisors (referred to collectively as “tax advisors”<sup>12</sup> in this Paper), in practice are often providing the same advice on tax law issues as lawyers. For example, Flint QC, representing the Institute of Chartered Accountants in England and Wales in *Prudential (CA)*, suggested that “[you] can’t distinguish between the two [i.e. tax advice provided by a tax accountant or lawyer]. They are performing the same function in the same context... Advice on tax is advice on law.”<sup>13</sup>

Given the above, it is perhaps not surprising that the rationale for the exclusivity of LPP has come under strong attack in recent times. Indeed in *Prudential (HC)*, Charles J in the UK High Court indicated that “... advice on tax is advice on law.”<sup>14</sup> His Honour continued:

“In my view Prudential have put forward a compelling and indeed unanswerable, case that in modern conditions accountants have the expertise to advise on tax and it is firms of accountants, rather than firms of solicitors, who give such advice and represent clients in disputes with the Revenue on many aspects of their tax affairs. Further many firms of accountants now employ lawyers to advise on tax and what they, and qualified accountants in the same form, do in this context is the same ...”;<sup>15</sup>

and later:

“I maintain that view, and agree that by reference to the need for confidentiality in respect of the giving of legal advice and the logic, purpose and public interest underlying legal advice privilege there is real strength in the argument that the extent of the right to refuse disclosure should not relate to the nature of the legal qualification of the person giving the advice ...”.<sup>16</sup>

However, while Schedule 36 contains some protections for tax advisors (which are discussed in Section 2 of this Paper), they are significantly more limited than the protections provided by LPP. This has created a significant imbalance in the protection accorded to the same tax advice when given by a

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<sup>12</sup> In this article the spelling “advisor” and “adviser” are used interchangeably recognizing the usage of the differing forms adopted in practice, for example “advisor” is used in the New Zealand statutory privilege legislation and “adviser” in the Finance Act 2008.

<sup>13</sup> K. Reed, “No distinction between accountants or solicitors on tax advice” (July 15, 2010), *Accountancy Age* at 1. Similarly, Lloyd LJ observed that in recent times it is not lawyers but accountants who give the majority of legal advice on taxation issues: “nowadays, on many if not most occasions on which a person will seek advice about fiscal liabilities, which often involves a consideration of, and advice about, the relevant law, that person does so by approaching accountants, rather than lawyers: *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [2]. However, this is not a universal view. For example, in *Tower v Minster of National Revenue*, 2993 FCA 307 [2004] 1 FCR. 183 at [2], [37] the Canadian Court stated that: “... Lawyers are legally and ethically required to uphold and protect the public interest in the administration of justice ... In contrast, accountants are not so bound. Nor do they provide legal services”.

<sup>14</sup> *R (on the application of Prudential Plc) v Special Commissioners of Income Tax* [2009] EWHC 4404 (QB) at [63].

<sup>15</sup> *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [64].

<sup>16</sup> *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [70]. In *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [86], Lloyd LJ in giving the leading judgment indicated that he agreed “with almost everything in the judgment of Charles J” (the exceptions are not relevant here), and Stanley Burton LJ indicated that he “entirely agree[d]” with the judgment of Lloyd LJ as did Mummery LJ.

lawyer as compared to an accountant (or other non-legal adviser) and resulted at times in “turf wars” between the professions, with some legal firms’ publications marketing their advantage.<sup>17</sup>

Over recent times, there appears to have been a groundswell of support for the view that the protection for the same advice given by lawyers and accountants should be given the same (or similar) protection, and some jurisdictions have introduced legislation designed to achieve this.

Thus, in 2005 NZ introduced legislation amending the Tax Administration Act 1994 (NZ) (TAA 1994) to grant a statutory privilege to confidential communications between accountants and other non-lawyer tax advisors and their clients created for the main purpose of providing or receiving tax advice.<sup>18</sup> More recently, the Australian Law Reform Commission (ALRC) proposed the introduction of a statutory protection for tax advisers based largely on the New Zealand model.

While these statutory privilege regimes provide some protection for advice from non-lawyers, they tend to be significantly narrower than their common law LPP counterpart. By way of contrast, s 7525(1) of the US Internal Revenue Code 1986 (IRC 1986) takes a different approach, by extending the benefits of LPP to any “federally authorized tax practitioner” – a term that includes certified public accountants and registered tax return preparers.

The key elements (and their pros and cons) of these international provisions are dealt with more fully in this Paper, where suggestions are made on aspects which the UK or other jurisdictions could usefully consider if they wished to balance more evenly the protection given to tax advice from lawyers and non-lawyers.

The balance of this Paper is structured as follows. Section 2 outlines the current information and inspection powers afforded the HMRC under the Finance Act 2008. The UK Court of Appeal’s unanimous decision in *Prudential (CA)* is analysed in section 3. The statutory privilege regimes operating in New Zealand and the ALRC proposal for a similar system in Australia are outlined in Sections 4 and 5, respectively. Section 6 reviews the protection for tax advisers in the US. Section 7 contains the concluding recommendations and observations including an outline of key points for policymakers to consider in developing any statutory regime.

A more detailed consideration of the nuances of the concepts of and rationale for LPP is beyond the scope of this Paper.<sup>19</sup> It is also not the purpose of this Paper to evaluate in detail the arguments – including the application of the European Convention on Human Rights (ECHR)<sup>20</sup> - and the policy

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<sup>17</sup> For example, the newsletter of one firm of US lawyers dated 28<sup>th</sup> October 2009 finished with the following paragraph: “... taxpayers who receive advice on tax law from accountants and other non-lawyers continue to have less protection than those receiving such advice from lawyers, and should therefore consult their lawyers and include them from an early stage in any projects”. This issue is not confined to the US: similar developments have been noted in Australia (in the Department of Treasury 2011 Discussion paper) and in Canada: A. Dodek, “Solicitor-Client Privilege in Canada: Challenges for the 21<sup>st</sup> Century”, (February 2011) *Discussion paper for the Canadian Bar Association* 45.

<sup>18</sup> K. Kendall, “Designing Privilege for the Tax Profession: Comparing the IRC Section 7525 with New Zealand’s Non-Disclosure Right”, available at [http://works.bepress.com/keith\\_kendall/3](http://works.bepress.com/keith_kendall/3), 15 ff. [Accessed 1 February 2012], 15 ff.

<sup>19</sup> For a discussion see for example: J. Wigmore, *A Treatise on the Anglo-American System of Evidence in Trials at Common Law*, 3rd ed, (Boston: Little, Brown & Company, 1940); B Thanki QC (ed), *The Law of Privilege* (Oxford: Oxford University Press, 2006), J. Auburn, *Legal Professional Privilege: Law and Theory*, (Oxford: Hart Publishing, 2000), c. 1; Dixon, above fn. 6, at 84-85.

<sup>20</sup> For a discussion of the ECHR and privilege see Dixon, above fn. 6, at 84.

merits (or otherwise) of extending privilege to non-lawyers<sup>21</sup> or of removing LPP altogether (at least in the tax context).<sup>22</sup> This Paper is based on the assumption that the UK or other jurisdiction has made the policy decision to equalise the levels of protection, and accordingly focuses on exploring how this might be achieved. Further, it is not the authors' intention to critically consider the Court of Appeal (or High Court) decisions in *Prudential* except insofar as they impact on the issues covered in this Paper.

## 2. THE UK INFORMATION AND INSPECTION POWERS - SCHEDULE 36, FA 2008

The current HMRC powers for carrying out inspections and information requests are contained in Schedule 36 of the Finance Act 2008.<sup>23</sup> These powers apply *inter alia* to income tax; National Insurance contributions; deductions under the Construction Industry Scheme; capital gains tax; corporation tax and VAT, and were expanded in 2010 to cover a range of other taxes and levies such as the Aggregates Levy, Inheritance Tax and Climate Change Levy.

Under Schedule 36, the HMRC can issue three different types of information notice for the purpose of checking a taxpayer's tax position:

1. A "Taxpayer notice" seeking relevant information and documents from the actual taxpayer;<sup>24</sup>
2. A "Third party notice" seeking information and documents concerning the tax position of a third party;<sup>25</sup> or
3. An "Identity unknown notice"<sup>26</sup> – requiring the production of information or documents concerning a person (or class of persons) whose identity (or identities) are unknown to the HMRC.<sup>27</sup>

The scope of these powers is very broad, as indicated by the "extremely wide"<sup>28</sup> definition<sup>29</sup> of "document",<sup>30</sup> which extends to "anything in which information of any description is recorded."<sup>31</sup> The term also includes part of a document (unless the context requires otherwise).<sup>32</sup>

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<sup>21</sup> For a summary of arguments both for and against a form of privilege to non-lawyers (and whether it should be restricted to lawyers), see for example R. McGill, "Legal Professional Privilege and Tax", 8 (2002) NZJTLP 341; B. Howell and L. Marriott, "Tax and Privilege: An Economic Perspective of Proposed Changes in New Zealand Taxation Policy", 8 (2002) NZJTLP 371; K. Kendall, "The Provision of Legal Advice by Tax Agents", *Paper presented at the Australasian Tax Teachers' Association Annual Conference*, (Brisbane, January 2007), at 3-8; Dixon, above fn. 3, 83, The [Australian] Treasury, *Privilege in relation to tax advice*, (April 15, 2011), at 11-15, available at <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2005>. [Accessed October 12, 2011].

<sup>22</sup> As noted above, Charles J acknowledged arguments for extending privilege to accountants and, alternatively, restricting or removing the right given to clients of lawyers: *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [73].

<sup>23</sup> These powers apply from 1 April 2009. Prior to 2009, the corresponding powers were contained in a range of provisions, particularly in ss 19A and 20 TMA.

<sup>24</sup> FA 2008 Sch. 36 para.1.

<sup>25</sup> FA 2008 Sch. 36 para.2. Where HMRC issue a Third party notice they must have agreement from the taxpayer concerned or approval from the First-tier Tribunal.

<sup>26</sup> HMRC, *CH23060 – Information & Inspection Powers: Information Notices: Three types of information notice*, available at <http://www.hmrc.gov.uk/manuals/chmanual/ch23060.htm>. [Accessed October 10, 2011].

<sup>27</sup> FA 2008 Sch. 36 para.5.

<sup>28</sup> Per Jones J in *R (on the application of Glenn & Co (Essex) Ltd v Commissioners of HMRC* [2010] EWHC 1469 (*Glenn*), at [14].

With the exception of LPP and related protections discussed below, the only specific restriction on these powers is that the document or information must be reasonably required by the HMRC officer issuing the information notice for the purpose of checking a person's "tax position". The term "tax position" is defined in Schedule 36 to include past, present and future liability to pay tax, penalties and other amounts,<sup>33</sup> and the definition has been criticised as being so broad "that the information power has been decoupled from the making of a self-assessment return so as to become a free-standing power at large."<sup>34</sup>

Paragraph 23 of Schedule 36 expressly provides that a person is not obliged to comply with an information notice if LPP applies. Paragraphs 24 and 25 provide more limited protection where information is sought from auditors and tax advisors, respectively. Significantly, for the purposes of this Paper paragraph 25 – which is discussed in Section 3.1 following – only protects a *tax advisor* from the obligation to produce documents or information; where an information notice is *instead* served on the taxpayer or a third party, the paragraph does not apply.

The broad inspection powers do not extend to entering premises used solely as a dwelling,<sup>35</sup> and normally at least seven days notice of an inspection will be given to the occupier.<sup>36</sup> However Schedule 36 (paragraph 10(1)) introduced a new and very broad inspection power for all taxes (including direct taxes) which – subject to certain restrictions – allows an HMRC officer to conduct an unannounced inspection of any "business premises",<sup>37</sup> "business assets"<sup>38</sup> and "business documents"<sup>39</sup> that are on the premises:

- at a time agreed by the occupier or,
- if notice has been given or the inspection is carried out by or with the agreement of an HMRC "officer"<sup>40</sup> or the approval of the First-tier Tribunal,<sup>41</sup> at any "reasonable time"

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<sup>29</sup> Jones J, in *Glenn*, above fn. 28, [2010] EWHC 1469, at 12 observes that "Section 114(2)(a) is not strictly a definition of 'document'; rather it extends the application of a provision to which it applies...".

<sup>30</sup> FA 2008 s.114(2).

<sup>31</sup> FA 2008 s.114(2). Jones J in *Glenn* concluded that the term "document" in s 114 FA 2008 extended to computer equipment: *Glenn*, above fn. 28, [2010] EWHC 1469 at [25]. His Honour also acknowledged, in response to a submission by the claimant, that the section could apply to a mobile telephone, an iPod, a camera or a USB stick.

<sup>32</sup> FA 2008 Sch. 36 para.58.

<sup>33</sup> FA 2008 Sch. 36 para.64(1)(a).

<sup>34</sup> D. Southern, "HMRC Powers: the New Order" (October 12, 2009), *Tax Journal*, available at <http://www.taxjournal.com/tj/print/20196>, [Accessed September 1, 2010].

<sup>35</sup> FA 2008 Sch. 36 para.10(2).

<sup>36</sup> FA 2008 Sch. 36 para.12(1)(b), (2)(a).

<sup>37</sup> This phrase is defined to mean: "premises (or any part of premises) that an officer of Revenue and Customs has reason to believe are (or is) used in connection with the carrying on of a business by or on behalf of the person.": FA 2008 Sch. 36 para.10(3).

<sup>38</sup> "Business assets" are "assets that an officer of Revenue and Customs *has reason to believe* are owned, leased or used in connection with the carrying on of a business by any person, excluding documents": FA 2008 Sch. 36 para.10(3)) (emphasis added).

<sup>39</sup> FA 2008 Sch. 36 para.10(3) defines "business documents" to mean "documents (or copies of documents) - (a) that relate to the carrying on of a business by any person, and (b) that form part of any person's *statutory* records". (emphasis added) However, an inspector may not inspect a business document to the extent that he could not at that time have required the occupier to produce the document under an information notice: FA 2008 Sch. 36 para. 28.

<sup>40</sup> The term is defined in Sch. 36 para.59.

provided the inspection is reasonably required for the purpose of checking a person's tax position.<sup>42</sup>

Upon entering business premises, an officer has power to inspect the premises and to copy, take extracts from or - if it appears necessary - remove and retain business documents for the purpose of checking a person's tax position.<sup>43</sup>

However, there are limits on these powers, and HMRC cannot require production of various classes of information or documents,<sup>44</sup> including a document more than six years after its creation, without the agreement of an authorised officer.<sup>45</sup>

Rights of appeal under Part 5 of Schedule 36 against information notices are limited, and there is no appeal at all where HMRC wish to see statutory records or the First-tier Tribunal approved the issue of the notice.<sup>46</sup>

As a result of the enactment of Schedule 36, Roberts and Esprin argue that the direct tax powers of HMRC have been "immeasurably strengthened, with former statutory safeguards, such as the necessity to obtain the independent leave of the ... General and Special Commissioners for section 20(1) and section 20(3) TMA notices, eliminated".<sup>47</sup> This change has been criticised as replacing law by administrative discretion,<sup>48</sup> with Macleod and Howard suggesting that under the new information powers<sup>49</sup> it will be [much] easier for HMRC to get the information it thinks it needs. Inspections of premises will be more common [and in] most situations there will be little restriction on HMRC's use of Sch 36."

Schwarz is particularly critical of the new powers of HMRC arguing that:

"The [information] power that has been conferred is broad and ill-defined, requiring no grounds of suspicion and constrained only by the condition that the power should be exercised only for the purpose of 'checking' a person's 'tax position'. HMRC guidance suggests that these new wide powers for the purpose of checking the tax position are intended and will be used as the equivalent to stop and search powers."<sup>50</sup>

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<sup>41</sup> FA 2008 Sch. 36 para.13(2).

<sup>42</sup> FA 2008 Sch. 36 para.10(1). Gordon raises concerns about the extensive scope of HMRC's powers to inspect a person's "business premises" observing that: "... to give the definition its broadest possible meaning, if a person carrying on a business sits in bed one morning and looks at or responds to the e-mails that have come overnight, then that person has used the bedroom in connection with a business, and the bedroom (at least) becomes susceptible to a visit.": K.M. Gordon, "Knock, knock" (August 6, 2008), available at <http://www.taxation.co.uk/taxation/articles/>. [Accessed October 10, 2011]. Schwarz echoes Gordon's concerns concerning the potentially broad definition of "business premises": J. Schwarz, "Rights and powers: protecting the legitimate interests of taxpayers" [2009] BTR 313.

<sup>43</sup> FA 2008 Sch. 36 para.16(1).

<sup>44</sup> FA 2008 Sch. 36, paras.19-28.

<sup>45</sup> FA 2008 Sch. 36 para.20.

<sup>46</sup> FA 2008 Sch. 36 paras.29(2),(3); 30(2),(3).

<sup>47</sup> P. Roberts and P. Esprin, "HMRC Powers", (October 13, 2008), *Tax Journal*, available at <http://www.taxjournal.com/tj/print/20655>. [Accessed September 1, 2010].

<sup>48</sup> Southern, above fn. 34.

<sup>49</sup> I. McLeod and M. Howard, "New Information Powers Regime" (October 13, 2008), *Tax Journal*, available at <http://www.taxjournal.com/tj/print/20655>. [Accessed September 1, 2010].

<sup>50</sup> Schwarz, above fn. 42, at 306-318, 312. He also observes that HMRC have other considerable powers under non-tax legislation (at 311).



Given the greatly increased scope of the tax authority's powers contained in Schedule 36, the level of protection given to tax advice from non-lawyers assumes even greater importance. It would seem that there has been no expansion of *protection* to balance the increase in investigative powers, and in the UK, tax advisers currently have only limited statutory protection from the exercise of HMRC investigation powers. In addition, and as clarified by the Court of Appeal in *Prudential (CA)*, tax advisers cannot invoke the common law legal professional privilege.

### 3. COMMON LAW LPP AND THE PROTECTION OF NON-LAWYERS

#### 3.1 *The decision in Prudential Plc: Common law LPP only protects tax law advice given by lawyers*

In *Prudential (CA)* the Court of Appeal was asked to consider whether the common law doctrine of LPP (in particular, legal advice privilege) applied to protect tax law advice given by a firm of accountants who were not legally qualified.

In that case, Prudential Plc and its Gibraltar subsidiary, Prudential (Gibraltar) Ltd (hereafter together referred to as Prudential) challenged their obligation to comply with notices issued under the former sub-sections 20(1) and (3) TMA requiring Prudential to produce documents relating to tax advice concerning a commercially marketed tax avoidance scheme provided by *inter alia* a leading firm of accountants. In simplified terms, Prudential argued that, "in the modern context"<sup>51</sup> because accountants routinely give legal advice regarding tax matters and performed the same (legal) work as lawyers in relation to tax advice, LPP should apply to the communications from the accountants.<sup>52</sup>

In the High Court in *Prudential (HC)* Charles J, had rejected Prudential's argument on the basis that he was bound by the Court of Appeal judgment in *Wilden Pump Engineering Co v Fusfeld (Wilden Pump)*<sup>53</sup> - where the court refused to apply common law LPP to advice given by patent agents. In Charles J's view, the ratio of *Wilden Pump* was that common law LPP applies only to advice given by members of the legal profession and could not be extended to a person who was not a lawyer, even where that person was giving "legal" advice which they were competent to give.<sup>54</sup> Accordingly, advice given by accountants to their clients could not fall within LPP.

As noted earlier, his Honour recognised the merit of the arguments<sup>55</sup> supporting the creation of a level playing field between clients of accountants (and other professionals) and lawyers in relation to the disclosure of confidential communications,<sup>56</sup> and also acknowledged that accountants now advise

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<sup>51</sup> *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [8].

<sup>52</sup> *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [8].

<sup>53</sup> *Wilden Pump Engineering Co v Fusfeld* [1985] FSR 159.

<sup>54</sup> *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [66].

<sup>55</sup> Charles J stated: "I ... agree that by reference to the need for confidentiality in respect of the giving of legal advice and the logic, purpose and public interest underlying legal advice privilege there is real strength in the argument that the extent of the right to refuse disclosure should not relate to the nature of the legal qualification of the person giving the advice....": *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [70].

<sup>56</sup> *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [73(2)]. His Honour suggested one solution to achieve parity between clients of different professionals – all of whom are receiving legal advice – could be to remove the right of clients of lawyers to refuse to disclose the legal advice they have been given: *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [71]. However, there has been little subsequent support for this suggestion.

clients on many aspects of tax law.<sup>57</sup> However, in Charles J's view, any equivalent right would have to be conferred by Parliament.

The Court of Appeal<sup>58</sup> in 2010 unanimously dismissed Prudential's appeal on the basis that it was bound by the decision in *Wilden Pump* to find that that at common law, LPP only applies to a qualified lawyer or an appropriately qualified foreign lawyer.<sup>59</sup>

However, Lloyd LJ stated that even if the court had not been bound by the *Wilden Pump* decision, the Court of Appeal would still have dismissed Prudential's appeal, because in the Court's view the absolute nature of LPP required that its scope and application be as clear and certain as possible. In Lloyd LJ's view, such certainty could be eroded to an unacceptable degree if LPP were extended to accountants,<sup>60</sup> because there were several professional bodies to which accountants in the United Kingdom can belong, and there was no single definition or recognised profession of an "accountant" in the United Kingdom (indeed, any person could set themselves up as an accountant and provide tax and other advice).<sup>61</sup> In Lloyd LJ's view, questions (and consequent uncertainty) would therefore arise as to which persons were/not "accountants" who should be able to claim LPP.<sup>62</sup>

Accordingly, in his Honour's view, a rule which simply stated that "LPP applied to communications with any person who can be described as an accountant for the purpose of obtaining or giving advice on a legal aspect of a client's tax affairs"<sup>63</sup> would not be acceptable. With all due respect, it is unlikely that any provision would be so loosely framed and, just as the term "lawyer" can be clearly defined, as discussed below so can that of "accountants".

Prudential had suggested various criteria to distinguish between accountants and non-accountants,<sup>64</sup> but Lloyd LJ held that these criteria simply served to illustrate the complexity of the matter.<sup>65</sup> "It is of the essence of the rule that it should be clear and certain in its application, since it is not the subject of any ad hoc balancing exercise but is, to all intents and purposes, absolute".<sup>66</sup> In addition, the Court rejected

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<sup>57</sup> *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [71(1)]. However, as Honour also observed, the lack of the protection (of LPP or an equivalent) for accountants' tax advice had not deterred clients from creating this situation (by using accountants instead of lawyers): *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [71(1)].

<sup>58</sup> The significance of this issue (of LPP and its application to accountants) led to the granting of permission to intervene in this appeal to the Institute of Chartered Accountants in England and Wales, the Bar Council and the Law Society.

<sup>59</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [82].

<sup>60</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [83]. Dixon similarly observes that there are a range of professionals who will at times advise on the law (subject, to restrictions imposed by the various *Legal Practitioners Acts* and their equivalents in the UK and Australia), and in each case, "expanding privilege to cover their advice and related communications will tend to erode another person's rights: Dixon, above fn. 6, 91.

<sup>61</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [73].

<sup>62</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [83]; S. Gordon, *Legislation Update – HMRC Information and Inspection Powers*, 77, available at <http://www.accountax-ltd/AccountaxConsultingLtd/hmrc-iip.htm>. [Accessed 1 September 2010].

<sup>63</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [73].

<sup>64</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [74]. The applicants suggested a definition modelled on s 330 of the Crimes Act 2002 which sets out the circumstances in which "an accountant, auditor or tax adviser who is a member of a professional body which is established for accountants, auditors or tax advisers" does not commit an offence under the Proceeds of Crimes Act 2002.

<sup>65</sup> Lloyd LJ did not share Charles J's view "that it would be possible for the court to prescribe the conditions subject to which an accountant would qualify as regards LPP.": *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [86].

<sup>66</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [83]. In *R v Derby Magistrates, ex parte B* [1996] AC 487, a case referred to by both the High Court and Court of Appeal in *Prudential*, Lord Nicholls observed that "subject to recognized

the argument that the issue could be determined solely by the *nature of the advice* (i.e. the *functional* similarity between tax advice given by a legal professional and an accountant) and therefore the function of the adviser, adopting instead an approach in which the identity of the provider of the advice (“status”) was also critical.

Arguments that extending privilege to accountants would create a “slippery slope” were also raised – i.e. that if privilege were extended to tax advisers, other groups such as patent attorneys, trade mark agents, immigration consultants and others would also seek extension of the privilege to them.<sup>67</sup>

Finally, the Court observed that where LPP applies to accountants it was as a result of statutory intervention, and while the Finance Act 2008 and its predecessor (section 20(5) TMA) provided limited protection with respect to accountants, a recommendation for a more general extension of LPP to accountants, which was proposed by the majority of the *Report of the Committee on Enforcement Powers of Revenue Departments* (1986) Cm. 8822 (Keith Committee),<sup>68</sup> had not been adopted. And while article 8 of the ECHR guaranteed protection for correspondence with a lawyer, it could not be taken to require the extension of that privilege to communications with any other person who might be asked to give legal advice (and even if it did, the limits of LPP could be justified under article 8(2) of the ECHR.)<sup>69</sup>

Accordingly, the court declined to extend the scope of the privilege to accountants.<sup>70</sup> The appeal to the Supreme Court has been set down for hearing on 6 November 2012.<sup>71</sup>

Arguably, Lloyd LJ overstated the difficulty of confining LPP to a determinable group of accountants. For example, a rule as in NZ that only accountants who are members of a specified (and pre-approved) Accounting body/bodies could rely on the privilege would be a precise and certain (if arbitrary) rule. It is hard to imagine that an acceptable formulation could not be found by intelligent people – afterall, the term “lawyer” has been defined.

His Lordship’s approach also relies on an increasingly contested view that lawyers have a unique position in the administration of justice because of their duty to the court, and may not take sufficient account of the fact that the privilege belongs to and is there to protect the client, and “has nothing to do with the protection or privilege of the lawyer”.<sup>72</sup>

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exceptions, communications seeking professional legal advice, whether or not in connection with pending court proceedings, are *absolutely and permanently privileged* from disclosure even though, in consequence, the communications will not be available in court proceedings in which they might be important evidence....” [at 510] (emphasis added)

<sup>67</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [78-79].

<sup>68</sup> *Report of the Committee on Enforcement Powers of Revenue Departments* (1986) Cm. 8822, as noted by Lloyd LJ in *Prudential (CA)*, above fn. 8, at [84]. Lloyd LJ also referred to the similar outcomes of the Law Reform Committee’s 6<sup>th</sup> Report and the Director-General of Fair Trading’s report on *Competition in Professions* (March 2001), which led Lloyd LJ to conclude that “Parliament’s failure to change the law in this respect is not an accident”: *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [51].

<sup>69</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [68-69].

<sup>70</sup> Gordon, above fn. 52, at 77.

<sup>71</sup> Hughes suggests that a successful appeal seems unlikely in light of the Court of Appeal’s decision: K. Hughes, “Accountants are not lawyers: legal professional privilege, accountants and the tax man”, 70(1) (2011) *Cambridge Law Journal* 21.

<sup>72</sup> *Daniels Corporation International Pty Ltd v Australian Competition and Consumer Commission* [2002] 213 CLR 543 at 87 (sic?), quoted in the Australian Department of Treasury *Discussion Paper - Privilege in relation to tax advice* (April

Further, Lloyd LJ's approach may also overstate the certainty of LPP as applied to lawyers. There has been no shortage of dilemmas thrown up over the years in various jurisdictions in relation to the application of LPP, including whether a sole or dominant purpose test is appropriate, whether the privilege applies to copies of documents, the test for implied waiver, and so on. It is therefore not clear that LPP has always been as commendably precise and certain as Lloyd LJ inferred.

Certainly some commentators have criticised trenchantly the Court of Appeal's decision in *Prudential (CA)*. Gordon believes that the court overstated the extent of the problem of defining the limit of any extended privilege and understated the degree of similarity between the accountancy and legal professions.<sup>73</sup> As he observes, the court's approach:

"... would seem to be a curious outcome. It is worth noting that the rule was made an absolute one by the courts because they regard it to be of particular importance not just to the individual, but to the administration of justice. One might have thought that this was an argument in favour of taking an expansive approach to the rule, so as to maximise its benefits. This impression is fortified when one considers that the rule has been described as 'a fundamental human right long established in the common law'."<sup>74</sup>

Gordon also suggests that:

"arguments based on status rather than function now appear rather anachronistic and backwards-looking... It is anomalous and ultimately illogical for the scope of a rule to be drawn more narrowly than is required by its function. If such an anomaly is to be tolerated, it must be because there are excellent reasons for so doing."<sup>75</sup>

His reasoning seems to have considerable force.

Higgins criticises the decision on the basis that the court failed "to consider properly the purpose of the rule, and [favoured] form over substance [as] the rule operates for the protection of clients".<sup>76</sup>

Whatever the merits of the various criticisms of the *Prudential (CA)* decision, it seems reasonable to infer that, on the basis of the existing judicial precedent, the UK courts are unlikely to expand the scope of the common law LPP doctrine to non-lawyers – even where, as in the High Court in *Prudential (HC)* there was acknowledgement of the disparities and issues the current position creates. Accordingly, given that accountants and other non-lawyer tax advisers cannot rely upon the common law, the adequacy of statutory protection becomes extremely important.

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2011), at [3], available at <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2005> (*Australian Treasury*). [Accessed 24 February 2012].

<sup>73</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [83].

<sup>74</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [72]. The impact of the status approach is mitigated in the larger accounting firms, which have a separate legal division where communications regarding legal advice can take place to ensure LPP protection. This option is not available to the smaller accountancy firms.

<sup>75</sup> Gordon, above fn. 62, at 77.

<sup>76</sup> Higgins, above fn. 11, at 190.

### 3.2. Statutory protection for non-lawyers in the UK

Part 4 of Schedule 36 provides a number of exceptions to the exercise of HMRC investigative powers, including paragraph 25.

#### 3.2.1 Paragraph 25, Schedule 36 FA 2008

Schedule 36, paragraph 25 enables a “tax adviser” to refuse to disclose information or documents in a very limited range of circumstances,<sup>77</sup> where a number of cumulative requirements are satisfied. Paragraph 25 provides that:

- A “tax adviser”
- is not required to provide information about, or
- make available documents which
- are the adviser’s property *and* which consist of
- “relevant communications”<sup>78</sup> between the tax adviser and either their client, or any other tax adviser of the client, where
- the purpose of the communication is the giving or obtaining of advice about any of the client’s tax affairs.

For these purposes, a “tax adviser” is defined broadly as “a person appointed to give advice about the tax affairs of another person (whether appointed directly by the client or by another tax adviser of that person)”.<sup>79</sup> The term “relevant communications” is defined as communications between the tax adviser and the person in relation to whose tax affairs they have been appointed, or any other tax adviser of that person, for the purpose of giving or obtaining any advice about those tax affairs.<sup>80</sup>

The protection of this exception is limited as follows. First, it only applies to documents which are “the adviser’s property”, and does not protect the advice in the hands of the client. This is curious since the policy basis for such privileges is the need for the client to feel confident that the (proper) advice they receive from their tax adviser will not be disclosed, and thus they can feel safe in confiding the truth to their adviser. Second, the exception does not protect communications between the tax adviser and other parties (such as valuers). Third, the paragraph does not protect all types of communication – for example, unlike LPP, it does not protect communications which are ancillary to the advice – e.g.

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<sup>77</sup> Some other jurisdictions such as Canada and South Africa offer no formal protection at all for tax advice by non-lawyers – in relation to Canada see *Tower v Minister of National Revenue* 2003 FCA 307; [2004] 1 FCR 183, [2], [37].

<sup>78</sup> As defined in FA 2008 Sch. para.25(3).

<sup>79</sup> FA 2008 Sch. 36 para.25(3). Charles J in *Prudential (HC)*, above fn. 14, [2009] EWHC 2494 at [45(6)] observed that the reference to “tax adviser” in the FA 2008 could include a lawyer, although was more obviously directed at accountants. In his Honour’s view, the paragraph was directed to the tax adviser’s own documents and to removing a conflict between tax advisers and their clients, “based on a duty of confidence in respect of ‘relevant communications’” and would be unnecessary if such communications were covered by LPP: [at 45(6)].

<sup>80</sup> FA 2008 Sch. 36 para.25(3).

background facts and assumptions. Finally, oral communications are not protected by paragraph 25 unless they constitute “information”.

In addition, under the express exception in paragraph 26(2), a tax adviser will be obliged to disclose documents or information (even if they are otherwise “relevant communications”) which:

- explain any information (or a document containing that information) which the recipient of the notice has, in their capacity as tax accountant, assisted any client in preparing for, or delivering to, HMRC;<sup>81</sup> or
- in the case of a notice which does not name the taxpayer - give the identity or address of any taxpayer to whom the notice relates or of any person who has acted on behalf of that taxpayer,<sup>82</sup>

*unless in either case* that information is already known to HMRC because it has already been provided to an HMRC officer or is contained in some other document or a copy which has been provided to an officer of the HMRC.<sup>83</sup>

This exclusion significantly erodes the protection given by Part 4 of Schedule 36 as it would be unusual for a letter giving tax advice not to set out the facts on which that advice is based.

As the above analysis indicates, the protection afforded by paragraph 25 is very limited, and there seems to be a credible argument – if it is accepted that tax advice provided by non-lawyers requires some form of equivalent protection to that provided by lawyers - that there is considerable scope for sensible extension of the protection given by paragraph 25.

### 3.2.2 *Options to increase protection for tax advice by non-lawyers*

The limited protection currently available under paragraph 25 is particularly noticeable when compared to the width of the common law legal professional privilege.

If the policy decision were taken to make the protection currently given to tax advisers closer to the protection given under LPP, there are two main approaches which could be applied.<sup>84</sup> In either case, insights gained from experiences in applying these approaches in other jurisdictions could be very useful in helping shape an “ideal” system – adopting the best of other systems and avoiding their mistakes:

1. Stand-alone statutory protection outside LPP. Under this approach, legislation would expand the protection provided under the current specific statutory protection for non-legal tax advisers (Schedule 36, paragraph 25) – an approach taken in New Zealand and one which is proposed for Australia; or
2. Extend the protection of legal professional privilege to non-lawyer tax advisers. This is the approach taken in the US under s 7525 IRC 1986.

These alternative approaches are discussed in the following three sections of this Paper.

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<sup>81</sup> FA 2008 Sch. 36 para.26(1).

<sup>82</sup> FA 2008 Sch. 36 para.26(2).

<sup>83</sup> FA 2008 Sch. 36 para.26(3).

<sup>84</sup> Treasury, above fn. 72, at [36 ff].

#### 4. POTENTIAL GUIDANCE FROM OTHER JURISDICTIONS: THE NEW ZEALAND MODEL

##### 4.1. *The “non-disclosure right” in New Zealand*

###### 4.1.1 *Introduction*

The New Zealand Inland Revenue Department (hereafter Inland Revenue or IRD) has extensive powers - not dissimilar to those available to the HMRC in Schedule 36 - to obtain information from taxpayers and their advisors.<sup>85</sup> A significant limit on these information gathering powers is that a person can refuse to disclose communications which are protected by legal professional privilege (LPP), which may attach to and protect from disclosure confidential communications between a lawyer and their client (and third parties in some circumstances).<sup>86</sup>

New Zealand is unique amongst common law countries, being the only major jurisdiction that has explicitly incorporated LPP (i.e. legal advice privilege) into its tax legislation<sup>87</sup> (through s 20 of the TAA 1994).<sup>88</sup> The same protection does not extend to communications between an accountant and their clients concerning tax advice, but a limited statutory privilege for advice provided by non-lawyer tax advisers was introduced in New Zealand in 2005 following a number of reports<sup>89</sup> (and considerable debate).

The tax advisors’ privilege (referred to in New Zealand as the “non-disclosure right” or “NDR”), aims to balance the taxpayer’s need for confidential and candid advice in relation to an increasingly complex tax system and the need for the CIR to be able to discover relevant facts relating to tax liability and compliance.<sup>90</sup> The NZ government justified the creation of the NDR on two inter-related grounds – that:

- it would encourage voluntary compliance on behalf of clients (and thus lead to a reduction in compliance and administrative costs),<sup>91</sup> because clients can come to their adviser and engage in a

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<sup>85</sup> The Inland Revenue’s primary information gathering powers are contained in sections 16 to 19 of the TAA 1994. Section 16 TAA 1994 provides the CIR with broad powers of access to taxpayers’ premises to obtain information and also permits the removal of such information for inspection. Section 17 confers similarly wide powers on the CIR to request any person to furnish information in writing (including documents) which the CIR considers “necessary or relevant” for any purpose relating to the administration or enforcement of the Inland Revenue Acts, or any other function lawfully conferred on the CIR. Sections 18 and 19 respectively give power to either a District Court judge or the CIR to hold an inquiry for the purpose of obtaining any information with respect to the tax liability of a person.

<sup>86</sup> Legal professional privilege was recognised in the tax context in *CIR v West-Walker* [1954] NZLR 191.

<sup>87</sup> K. Keating and N. Campbell, “Privilege for Tax Advice”, 2011 Tax Conference, New Zealand Institute of Chartered Accountants, at [6.1].

<sup>88</sup> Section 20 TAA 1994 provides that any information or document is protected from disclosure if: (a) it is a confidential communication, whether written or oral, passing directly or indirectly between legal practitioners in their professional capacity or a legal practitioner in their professional capacity and a client; (b) it is made or brought into existence for the purpose of obtaining or giving legal advice; and (c) if it is not made for the purpose of committing or furthering some illegal or wrongful act. Trust accounts and related financial records are expressly excluded from protection by paras 20(2) and (3).

<sup>89</sup> See A.J. Maples and M. Blissenden, “The proposed client-accountant tax privilege in Australia: How does it sit with the common law doctrine of legal professional privilege” 39 (2010) ATR, at 22.

<sup>90</sup> G. Tubb, “Inland Revenue’s Perspective on Non-Disclosure Rights”, *Paper presented at the New Zealand Institute of Chartered Accountants’ Tax Conference*, (Rotorua, October 2005), at 2.

<sup>91</sup> IRD, *Taxation (Base Maintenance and Miscellaneous Provisions) Bill; Commentary on the Bill*, (2004), at 44, available at <http://www.taxpolicy.ird.govt.nz/publications/files/novbill04comm.doc>. [Accessed at October 17, 2011].

full and frank discussion of their tax affairs without fear their confidential discussions may later be disclosed to the IRD; and, likewise

- it enables accountants to “give candid and independent advice to their clients”.<sup>92</sup>

#### 4.1.2 Key elements of the New Zealand tax advisors’ NDR privilege

The NDR, which is contained in sections 20B to 20G of the TAA 1994, applies to requests to disclose information made by the IRD after 21 June 2005 and to “tax advice documents” created before or after that date.<sup>93</sup>

The tax advisors’ privilege supplements but does not replace LPP. Confidential communications between legal practitioners and their clients which are protected by LPP under section 20 TAA 1994 do not require NDR protection and therefore fall outside the scope of the NDR.<sup>94</sup> Similarly, litigation privilege remains unaffected by the NDR.

Section 20B(1) TAA 1994 sets out the operative provisions of the NDR, and provides that:

“A person (called in this section and sections 20C to 20G an information holder) who is required under 1 or more of sections 16 to 19 to disclose information in relation to the information holder or another person is not required to disclose a document that is a tax advice document for the person to whom the information relates.”

The following key concepts underpin the operation of the statutory privilege, and are defined in the TAA 1994:

#### “Tax advisor” and the “Approved Advisor Group”

As noted earlier, one of the major concerns raised by Lloyd LJ the UK Court of Appeal in *Prudential (CA)* was that if the Court were to extend LPP to accountants, the scope of the privilege would be uncertain because there was no clear single definition of an “accountant” for the purposes of any expanded privilege.<sup>95</sup> Lloyd LJ noted that there were several professional bodies to which accountants in the United Kingdom could belong, and there was no recognised profession of “accountant” in the United Kingdom - any person could set themselves up as an accountant and provide tax and other advice.<sup>96</sup>

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<sup>92</sup> IRD, above fn. 91, at 44. For a discussion of the rationale for the creation of tax advisors’ privilege see A.J. Maples and M. Blissenden, above fn. 89, at 28-31.

<sup>93</sup> The IRD’s approach to applying the statutory privilege is outlined in Standard Practice Statement: IRD, “Non-Disclosure Right for Tax Advice Documents – SPS 05/07” 17 (2005) *Tax Information Bulletin* 23 (SPS 05/07). For a discussion of the process for claiming the statutory right see A.J. Maples, “The non-disclosure right in New Zealand – Lessons for Australia?” (2008) JALTA, at 360-363.

<sup>94</sup> The New Zealand Government also made it very clear from an early stage that there is no intention for the non-disclosure right to affect common law privilege: IRD, *Taxation (Base Maintenance and Miscellaneous Provisions Bill 2004 – Explanatory Note*, (IRD, November 2004), at 10, available at <http://taxpolicy.ird.govt.nz/publications/files/bills/231bar1.pdf>. [Accessed October 26, 2011].

<sup>95</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [73], [83].

<sup>96</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [73].



This uncertainty in the UK was addressed by the New Zealand Parliament in the NDR by providing that the statutory NDR privilege only attached to advice from a “tax advisor”, and then defining “tax advisor” in relatively clear (if indirect) terms.<sup>97</sup> Interestingly, the term “tax advice” is not defined, but the key term of “tax advisor” is defined as a natural person who - at the time the relevant (tax advice) document was created – “is subject to the code of conduct and disciplinary process ... of an approved advisor group”.<sup>98</sup>

The reference in the definition of “tax advisor” (and “approved advisor group”) to a “natural person” focuses on the individual who is *giving* the advice, and means that incorporated professional practices or trusts as such are excluded from the definition of “tax advisors”. This was a conscious policy decision made by the government, which was concerned that “that the ability to claim the right of non-disclosure should be limited to persons who are themselves subject to the disciplinary rules of the approved body”.<sup>99</sup> Where an accountancy practice operates through a limited liability company or trust “a principal of the firm who is a member of an approved group or subject to the group’s rules [will be required] to claim the privilege”.<sup>100</sup>

An “approved advisor group” is then defined as:

“ a group that

(a) includes natural persons who—

(i) have a significant function of giving advice on the operation and effect of tax laws; and

(ii) are subject to a professional code of conduct in giving the advice; and

(iii) are subject to a disciplinary process that enforces compliance with the code of conduct; and

(b) is approved by the Commissioner of Inland Revenue (CIR) for the purposes of this definition.”<sup>101</sup>

Approved advisor group status has been accorded to the New Zealand Institute of Chartered Accountants (NZICA) and the Tax Agents’ Institute of New Zealand (Inc.).<sup>102</sup>

Partners, principals and employees in accounting practices who are members of an approved advisor group will therefore be “tax advisors” within this definition, as will an employee of a tax advisor’s firm where the tax advisor is in public practice even though the employee themselves may not have this

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<sup>97</sup> The NDR belongs to the client, and must be claimed by the client or by an authorised tax adviser on their behalf: TAA 1994 s. 20D(2),(3).

<sup>98</sup> TAA 1994 s. 20B(4).

<sup>99</sup> Policy Advice Division, IRD and the New Zealand Treasury, *Taxation (Base Maintenance and Miscellaneous Provisions) Bill — Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill* (IRD and NZ Treasury, 2005), at 104.

<sup>100</sup> IRD and the NZ Treasury, above fn. 99, at 104.

<sup>101</sup> TAA 1994 s. 20B(5).

<sup>102</sup> The Keith Committee in 1983 recommended LPP be extended to tax agents who were “admitted members of an incorporated society of accountants or of the Institute of Taxation”: *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [50(ii)].

professional affiliation. Non-members can fall within the scope of the NDR where they are practising in partnership with a member of an approved advisor group. In-house tax advisers will also be “tax advisors”, but will need to ensure that they are able to distinguish tax advice from work which is commercial or transactional in nature (which will not be protected by LPP or the non-disclosure right).

It is worth noting that the criteria for an “approved advisor group” would seem to meet Lloyd LJ’s concerns for a clear definition of an eligible “accountant”, and would thus meet one of his conceptual objections to extension of LPP to non-lawyers. This suggests, as indicated above, that it is quite possible to develop adequate definitions which would meet the requirements of certainty for extension of LPP.

#### A “tax advice document”

While the term “tax advice” is not defined directly in the TAA 1994 (a situation that could easily be rectified if perceived to be a shortcoming), the legislation instead provides that the tax advisors’ privilege only protects advice given in a “tax advice document”.

In order for a document<sup>103</sup> to be a “tax advice document” it must satisfy the criteria for eligibility and a claim (that it is a tax advice document) must be made within the relevant period. These key aspects are now discussed.<sup>104</sup>

The document must be *eligible* to be a tax advice document.

A document is *eligible* to be a “tax advice document” *for a particular person*<sup>105</sup> if it is:

(a) **confidential**. When confidentiality is lost, so too is the privilege. Advisers and taxpayers therefore need to be careful to ensure that confidentiality is not compromised by unnecessary and wide circulation that may be held to destroy the confidentiality of the advice.<sup>106</sup>

(b) **created by either**:<sup>107</sup>

(i) **the taxpayer** for the *main* purpose of instructing a tax advisor to give advice on the operation or effect of tax laws; or

(ii) a **tax advisor** (or an employee of the tax advisor’s firm where the advisor is in public practice) for the *main* purpose of giving advice about the operation and effect of (NZ) tax laws.

A tax advice document may either record tax advice previously provided to the taxpayer by the tax advisor (for example, a letter of opinion, file note or email), or may record research or analysis of tax laws performed by a tax advisor for the main purpose of giving tax advice to the client.

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<sup>103</sup> As with the UK equivalent in the Finance Act 2008, the term “document” is broadly defined in s 3 TAA 1994 (and includes electronic communications such as emails, faxes (and presumably social media) as well as computer hard drives: *Avowal Administrative Attorneys Ltd v District Court at North Shore* [2010] NZCA 183)).

<sup>104</sup> TAA 1994 s. 20B(3).

<sup>105</sup> The requirement that eligibility for NDR status is judged in relation to “the person to whom the information relates” is another limit on the scope of the privilege.

<sup>106</sup> Keating and Campbell, above fn. 87, at 4-5.

<sup>107</sup> TAA 1994 s. 20B(2).

In order to satisfy this element of the definition, the document must have been created for the “main” purpose of giving or receiving advice on tax laws.<sup>108</sup> New Zealand has adopted a “dominant purpose” test for legal professional privilege, but – strangely – applies a “main purpose” test for tax adviser privilege. The better view would seem to be that the use of the word “main” instead of “dominant” is of no significance – the courts have indicated the words are synonymous<sup>109</sup> – and its usage in this context is probably the result of a move to the plain English drafting style adopted in New Zealand.

Nevertheless, it would have been preferable if a standard clause had been used in both contexts, and in any UK version of a statutory tax adviser privilege it would arguably be preferable to adopt a “dominant” purpose test, as this appears to be the more common term (and would be consistent with the approach of the courts in the UK).

(c) **not been created** “for the purpose of committing or promoting or assisting the committing of, an **illegal or wrongful act**”.<sup>110</sup>

Concern has been expressed in NZ over the breadth of this exclusion,<sup>111</sup> particularly the issue of whether the use of the term “wrongful” could exclude documents where there is the potential for the statutory anti-avoidance provisions to be applied.<sup>112</sup> This issue has also caused concern in Australia because of the Australian Tax Office’s (ATO) (perceived) increasing tendency to apply the “exceptional circumstances” exclusion to deny the accountant’s administrative concession (discussed in Section 5 of this Paper) where the ATO alleges that the general anti-avoidance provisions in Part IVA ITAA 36 may apply.<sup>113</sup>

Unlike tax evasion, tax avoidance is not illegal. However, it might be regarded by some as being against the spirit of the law, so that arguably advice regarding a tax avoidance arrangement may be seen as promoting or assisting the commission of a ‘wrongful act’. Such a view seems extreme (though the Australian experience gives cause for concern), but if adopted, it would mean that the document would not be a (privileged) “tax advice document”. Such an interpretation could severely restrict the coverage of the privilege.”<sup>114</sup>

Clearly, it would be essential to avoid uncertainty by dealing with this issue expressly in any tax advice protection legislation.

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<sup>108</sup> *Waugh v British Railways Board* [1979] UKHL 2; [1980] AC 521; *Silver Hill Duckling Ltd v Minister for Agriculture* [1987] IR 289. See also *Dinsdale v CIR* (1998) 18 NZTC 13,583 and *Miller v CIR* (1997) 18 NZTC 13,001 (with respect to LPP in the tax context) and *Guardian Royal Exchange v Stuart* [1985] 1 NZLR 596.

<sup>109</sup> See for example, Case J in *CIR v National Distributors* (1989) 11 NZTC 6,346, at 6,355; Maples and Blissenden, above fn. 89, at 35-36.

<sup>110</sup> TAA 1994 s. 20B(2)(c). The equivalent common law exception in Australia refers to “anything that might be described as a fraud on justice” or a purpose contrary to the public interest: *A-G (NT) v Kearney* (1985) 158 CLR 500, 514; *Kennedy v Wallace & Ors* [2004] FCA 332.

<sup>111</sup> Section 20 of the TAA 1994, providing for legal advice privilege, uses similar wording.

<sup>112</sup> A. Judge and A. Williams, “Questions and answers on the practical implications of privilege”, *Paper presented at the New Zealand Institute of Chartered Accountants’ Conference*, (Rotorua, October 2005), at 16.

<sup>113</sup> Institute of Chartered Accountants in Australia, *Submission on ALRC Discussion Paper Appendix C*, at [2]. (ICAA).

<sup>114</sup> A.J. Maples and R.H. Woellner “Privilege for accountants’ tax advice in Australia – brave new world, or house of straw?” 25 (2010) ATF 143.

A. The taxpayer or their authorised tax advisor<sup>115</sup> must make a *claim* that the document is a tax advice document within the prescribed time limit.<sup>116</sup> However, a document that is *possibly eligible* to be a tax advice document is presumptively treated as being a tax advice document from the time the information or discovery request is made until the earlier of either the expiry of the statutory time limit for claiming privileged status, or when the person informs the IRD that they are not claiming the NDR in relation to the document.<sup>117</sup>

If an NDR claim *is* made within time, the document is then presumptively treated as a tax advice document until:

- it is ruled not to be so;
- the person in writing withdraws their claim or agrees that it is not a tax advice document; or
- an approved advisor group informs the IRD that the tax advisor was not a member of an approved group at the time they claimed to be a member of the group.<sup>118</sup>

Under the NZ legislation, a claim for the NDR can only be made by the taxpayer or their authorised tax adviser *after* the IRD has made a formal request for access to or disclosure of information under sections 16-19 TAA 1994. Often this will occur at the later stages of the taxpayer audit, by which time it is likely that IRD officers may have already had access to or seen what may later be claimed to be “tax advice documents”. The timing requirement therefore creates obvious potential problems for taxpayers and advisors and may reduce or entirely remove the protection of the NDR.

This issue does not arise in the context of legal professional privilege, which can be asserted at the commencement of the information-gathering process, and the policy rationale for this difference in timing between LPP and the tax adviser’s privilege in NZ is not immediately clear. Accordingly, in any UK statutory advisor’s privilege, the position under a NDR should be equated to that under LPP and the adviser or client should be able to claim the privilege at any time.

Where there is a dispute as to whether a document is a “tax advice document”, the CIR or tax advisor can apply to a District Court Judge, or to the court, or Taxation Review Authority hearing the proceedings for an order determining the non/privileged status of the document or information.<sup>119</sup>

#### *Documents or information that must be disclosed to the IRD*

Various categories of documents or information must be disclosed to the IRD:

1. Any part of a document that is *not* a tax advice document;

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<sup>115</sup> TAA 1994 s. 20D(1).

<sup>116</sup> The time within which a claim must be made varies depending upon the process by which the request for information was made: see TAA 1994 s. 20D(4).

<sup>117</sup> TAA 1994, s. 20D(2).

<sup>118</sup> TAA 1994, s. 20C(3). While a document is being treated as presumptively privileged under these provisions, a tax advisor must hold a copy in a secure place: TAA 1994 s. 20C(4).

<sup>119</sup> TAA 1994 s 20G(1)-(4).

2. A document or part that is attached to a tax advice document, but is itself not eligible for NDR protection: for example, a statement of background information or financial statements facts which is attached to a tax advice document.

3. Perhaps the most significant exclusion from NDR protection is the requirement for disclosure of “tax contextual information” – even if contained in an otherwise protected tax advice document.<sup>120</sup>

“Tax contextual information” in relation to a person is defined broadly under s 20F(3) TAA 1994 and includes a description of the facts and assumptions relating to transactions and steps in transactions (whether they have occurred or are postulated),<sup>121</sup> non-tax advice (for example, financial, accounting, investment and valuation advice) and related facts and assumptions; and advice on the collection of debts payable to the CIR.<sup>122</sup>

In SPS 05/07, the IRD indicated that among the documents it regards as not falling within the NDR protection are *included*:

- documents that simply record decisions or transactions, set out calculations or summarise facts,
- documents or forms completed for the main purpose of meeting tax compliance obligations;
- transfer pricing reports, financial, board minutes, valuation reports, invoices, agreements and other transaction documents; and
- structure diagrams, memoranda of understanding, guarantees, communications with third parties, employment contracts, confidentiality agreements, bank statements, and other similar documents.

This represents a significant difference to the position under LPP, where contextual information would generally be protected.

Tax contextual information must be disclosed by way of a statutory declaration.<sup>123</sup> The IRD views the requirement for a statutory declaration as an important element of the process, as it protects the integrity of the privilege.<sup>124</sup> The requirement seems to serve a useful policy purpose and should be a feature of any model statutory tax advice regime.

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<sup>120</sup> The Keith Committee recommended a distinction “be made between documents containing facts necessary to determine the true tax liability, which if subject to LPP should be disclosed if the claim to LPP would reasonably impede the ascertainment of facts necessary to the proper ascertainment of the taxpayer’s tax liabilities; and advice, which should not be disclosed.”: per Dr Avery Jones in *A Plc, Re an application by the Commissioners for Her Majesty’s Revenue and Customs to Serve a Section 20(3) Notice* [2007] UKSPC00647; [2008] STC (SCD) 358 at [7].

<sup>121</sup> The word ‘postulated’ refers to a transaction that ‘will or is expected to occur or is assumed to have occurred’: IRD, above fn. 93, 29. It would apply, for example, where a tax advisor provided advice on a contemplated transaction, but was no longer acting for the taxpayer when the transaction took place and has no real knowledge of how the advice was implemented: IRD and the NZ Treasury, above n 99, at 110.

<sup>122</sup> TAA 1994 s. 20F(3).

<sup>123</sup> TAA 1994 s. 20F(4). See the prescribed form: IRD, *Tax contextual information disclosure form IR 520*, available at <http://www.ird.govt.nz/forms-guides/number/forms-500-599/ir520-form-taxcontext.html>. [Accessed 3 October 2011]. A tax advisor may be barred from giving such statutory declarations if convicted of certain offences: TAA 1994 s 20F(5).

<sup>124</sup> IRD and the NZ Treasury, above fn. 99, at 117.

#### 4.2 *Limitations on the scope of the tax advisors' privilege*

While the non-disclosure right serves a similar broad function to LPP, the content of the rules is quite different and the scope of the non-disclosure right is subject to a number of limitations that do not affect legal professional privilege:

1. The NDR does not protect factual information or assumptions. Accordingly, tax advisors need to ensure that background facts and assumptions are dealt with separately in a tax advice document, so that they can easily be extracted and disclosed if needed.<sup>125</sup>

2. The NDR does not apply to oral advice or to information generally, being limited to written communications (documents). The privilege therefore does not provide complete protection from disclosure for taxpayers and tax advisors facing the very wide information gathering sections in New Zealand - for example, under section 17(1) TAA 1994 which requires a tax adviser to "furnish in writing any *information* ... which the Commissioner [of Inland Revenue] considers necessary or relevant". (emphasis added)

By contrast, LPP protects communications in all forms, written and oral.

3. The advisors' privilege does not extend to advice on other areas of the law (such as company law arrangements related to a tax minimisation arrangement).

4. The NDR only applies to tax advice about New Zealand tax rules as they affect the particular taxpayer.<sup>126</sup> Tax advice about the effect and application of tax laws in another jurisdiction (for example a country in which a controlled foreign company is resident) are therefore not protected.<sup>127</sup> By contrast, common law privilege, as codified by section 20 TAA 1994, would protect advice by a lawyer concerning foreign tax laws, or advice provided by an appropriately qualified foreign lawyer.<sup>128</sup>

5. Legal privilege continues until it is lost by either express or implied waiver. By contrast, as NDR must be claimed, the New Zealand courts' view is that the statutory advisor's privilege cannot be waived – although, as discussed above, for practical purposes LPP and the NDR operate in a largely similar way as once claimed the NDR rules presumptively apply.

The protection afforded by the tax advisors' privilege is therefore significantly more limited than LPP in respect of the same advice.<sup>129</sup>

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<sup>125</sup> R. Wells, "All About Tax Contextual Information", (November 10, 2005), *New Zealand Institute of Chartered Accountants*, available at [http://www.nzica.com/AM/Template.cfm?Section=Non\\_disclosure\\_Tax\\_Articles](http://www.nzica.com/AM/Template.cfm?Section=Non_disclosure_Tax_Articles). [Accessed December 19, 2009].

<sup>126</sup> IRD, above fn. 93, at 29.

<sup>127</sup> This exclusion for non-New Zealand tax laws will raise issues for tax advisors whose client is seeking advice on transactions involving foreign and domestic taxation; the tax advisors' privilege could only be claimed in these circumstances if the advice on the United Kingdom tax position was given for a purpose subsidiary to the main purpose of advice on New Zealand tax laws, or - possibly - the issues were dealt with in separate opinions.

<sup>128</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [82]; N. Williams, "Right of Non-disclosure for Tax Advice Documents" 5 (2005) *NZ Tax Planning Report* 40.

<sup>129</sup> For a discussion of comparison of LPP and statutory privilege see Maples and Blissenden, above fn. 89, at 14-18.

### 4.3 NDR in the New Zealand courts

Since the enactment of the statutory privilege, two significant NZ cases have considered aspects of the non-disclosure right. The impact of the first case, *ANZ National Bank Ltd v CIR*,<sup>130</sup> was corrected by a legislative amendment in 2009<sup>131</sup> which overcame the highlighted anomaly by extending the protection of the NDR to prevent disclosure of documents sought by the IRD during the discovery and litigation process.

The more significant and enduring of the cases is *Blakeley v CIR (Blakeley)*.<sup>132</sup> Mr Blakeley, director of an accountancy firm, claimed the non-disclosure right in respect of a request by Inland Revenue for him to provide a list of the names and IRD numbers of clients to whom tax advice had been provided in relation to specific transactions. Rodney Hansen J<sup>133</sup> in the New Zealand High Court held that the names and IRD numbers were not a “tax advice document” as defined;<sup>134</sup> but were instead information, and therefore not covered by the non-disclosure right.<sup>135</sup> His Honour also indicated that it would be unlikely that the list of names would have been privileged even if LPP had been in issue.<sup>136</sup>

Of particular significance is that his Honour found that the tax advisor privilege was “significantly narrower than the scope of legal professional privilege both as to the information protected from disclosure and the conditions attaching to its application ... [because as] a creature of statute [it only] protects defined parts of a limited category of written communications.”<sup>137</sup> In his Honour’s view, the statutory right was not an extension of LPP and therefore principles of legal professional privilege were not relevant<sup>138</sup> - the words of sections 20B-20G TAA 1994 should be given their plain and ordinary meaning within the context of the scheme and purpose of the TAA 1994.

This approach has led to what has been described by some commentators as a “narrow, non-contextual and literal”<sup>139</sup> application of the statutory right. However, support for his Honour’s conclusion might be found in the fact that in 2005 the NZ Parliament declined the opportunity to extend LPP to tax advisors, choosing instead to create a more limited statutory NDR privilege which while containing several exceptions, would “place the status of communications from non-legal advisors, such as accountants, *closer* to that of the tax advice provided by lawyers, who do not have to disclose advice to the Inland Revenue Department.” (emphasis added)<sup>140</sup>. Similarly, the Explanatory Note to the

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<sup>130</sup> *ANZ National Bank Ltd v CIR* (2009) 24 NZTC 23,465 (CA). See also *Blakeley v CIR* (2008) 23 NZTC 21,865 (HC), 21,868.

<sup>131</sup> The Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 (NZ).

<sup>132</sup> *Blakeley v CIR* (2008) 23 NZTC 21,865 (HC).

<sup>133</sup> Agreeing with the New Zealand District Court: *CIR v Blakeley* (2008) 23 NZTC 21,681 (DC).

<sup>134</sup> The inspection and information gathering powers of the CIR under sections 16 and 17 previously referred to “books and documents”. The Taxation (Tax Administration and Remedial Matters) Act 2010 (NZ) replaces this term with the simpler term “document”.

<sup>135</sup> *Blakeley*, above fn. 132, (2008) 23 NZTC 21,865 at 21,869.

<sup>136</sup> *Blakeley*, above fn. 132, (2008) 23 NZTC 21,865 at 21,870. In Australia, a list of the names of clients involved in a particular tax arrangement has been held not to be protected by LPP on the basis that disclosure of the clients’ names did not disclose the substance of the legal advice given to them: *FC of T v Coombes (No.2)* 99 ATC 4634 at 4643 (*Coombes*).

<sup>137</sup> *Blakeley*, above fn. 132, (2008) 23 NZTC 21,865 at 21,868 - 21,869.

<sup>138</sup> *Blakeley*, above fn. 132, (2008) 23 NZTC 21,865 at 21,870.

<sup>139</sup> R. Geldenhuys and E. Trombitas, “*Blakeley v CIR* and the Non-Disclosure Right: A Decision Out of Context”, 14 (2008) NZJTL 303 at 311.

<sup>140</sup> The Hon Dr M. Cullen, “Taxation (Base Maintenance and Miscellaneous Provisions) Bill 2004: First Reading”, (2004) *Hansard* 622, 18,054.

Taxation (Base Maintenance and Miscellaneous Provisions) Bill 2004 stated that: “[t]he proposed provisions will provide a *degree of consistency* with the current privilege enjoyed by a lawyer’s client ...”.<sup>141</sup> (emphasis added) How close this degree of consistency was intended to be is a contentious issue<sup>142</sup> and beyond the scope of this Paper.

Calls for legal professional privilege simply to be extended to tax advisors were rejected on the basis that to do so could harm the tax base due to the amount of documentation about taxpayer’s affairs held by accountants, as accountants are the largest single group of tax agents and tax advisors in New Zealand and, accordingly, are responsible for a very sizeable percentage of tax returns filed.<sup>143</sup> An extension of LPP to accountants would mean “more information would be protected by privilege and the effect could be a significant loss of government revenue.”<sup>144</sup>

It is interesting that one of the main objections to extension of the tax advisors’ privilege in New Zealand was based on revenue impact rather than principle. This has arguably compromised the protection afforded by the NDR. Keating and Campbell lament that despite the similarities that do exist between the NDR and LPP and the intention behind the NDR, “it would seem that the objective of extending LPP has been only partially achieved.”<sup>145</sup> In approaching the question of whether or not to strengthen the UK or other statutory tax adviser’s privilege, the emphasis should be on policy rather than expediency.

## 5. POTENTIAL GUIDANCE FOR OTHER JURISDICTIONS: AUSTRALIA, THE ALRC PROPOSAL AND INSIGHTS FOR THE UK

### 5.1 *Australia and the ALRC Proposal*

In Australia (as with Canada and South Africa among others), legal professional privilege currently does not apply in relation to tax advice communications provided to clients by tax advisers who are not legally qualified. Instead, the ATO applies an administrative practice (referred to as the “accountants’ concession”) which was developed by the ATO and is not legally enforceable.<sup>146</sup> Under the accountant’s concession, the ATO will only seek access in “exceptional circumstances” to “restricted source”<sup>147</sup> and “non-source”<sup>148</sup> tax advice documents prepared by recognised accountants for the sole<sup>149</sup> purpose of providing tax advice to clients, but will seek full access to “source” documents.<sup>150</sup>

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<sup>141</sup> IRD, above fn. 94, at 10.

<sup>142</sup> Geldenhuys and Trombitas, above fn. 139, at 307-308.

<sup>143</sup> IRD and the NZ Treasury, above fn. 99, at 99.

<sup>144</sup> IRD and the NZ Treasury, above fn. 99, at 99.

<sup>145</sup> Keating and Campbell, above fn. 87, at 16.

<sup>146</sup> However, Australian courts have held that the Accountant’s Concession guidelines issued by the ATO create a legitimate expectation that the ATO will not depart from the guidelines without giving the person concerned an opportunity to make a case on why the ATO should not do so; and would give the person affected an opportunity of arguing that there were no “exceptional circumstances” justifying the lifting of the protection: *ONE.TEL Ltd v DC of T* (2000)101 FCR 549; 2000 ATC 4229; cf *Deloitte Touche Tomatsu v DFC of T* (1998) 98 ATC 5192; (1998) 40 ATR 435; and see the ATO, *Access and Information Gathering Manual*, [Chapter 7], available at <http://www.ato.gov.au/corporate/content.aspx?doc=/content/51035.htm>. [Accessed February 1, 2012].

<sup>147</sup> “Restricted source” documents shed light on the transaction or arrangement”: ATO, above fn. 146.

<sup>148</sup> “Non-source” documents are other advice documents: ATO, above fn. 146.

<sup>149</sup> At the time the Accountants Concession guidelines were introduced, the Australian courts applied a “sole purpose” test for common law LPP. The decision in *Esso Australia Resources Ltd v FC of T* 2000 ATC 4002 subsequently changed the



However, because it does not have statutory force, the administrative concession is a fragile protection, and the accounting profession has regularly voiced concerns that the ATO takes too liberal a view of when “exceptional circumstances” exist justifying the ATO in waiving the protection and accessing confidential taxation advice.<sup>151</sup>

In response to these and other criticisms, the Australian Federal Attorney-General in November 2006 announced an inquiry by the ALRC into LPP, and how it affects Commonwealth bodies - including the Australian Commissioner of Taxation – exercising coercive information gathering or associated powers, and whether a privilege should be extended to accountants or other tax advisers.

The resulting ALRC report *Privilege in Perspective: Client Legal Privilege in Federal Investigations* (the ALRC report)<sup>152</sup> followed the New Zealand model in many respects and recommended, among many other things, the establishment of a statutory tax adviser privilege for those advisers who are not legally qualified.<sup>153</sup> In April 2011, the Australian Treasury released a follow-up Discussion Paper, “*Privilege in relation to tax advice*”, which (assuming a decision were made to introduce a statutory tax advice privilege) outlined the NZ and USA approaches as possible alternatives.

The ALRC report observed that the (possible future) creation of a separate statutory privilege in Australia would “allow Parliament greater control over the operation and scope of the tax advice privilege”.<sup>154</sup> The Australian Treasury Discussion Paper observed such a privilege would “effectively formalise – and to some degree extend – the existing accountants’ concession”<sup>155</sup> – and might “in light of the rationale for legal professional privilege ... [and considerations of competitive neutrality] cover both lawyers and accountants who provide tax advice”.<sup>156</sup>

Observers have noted, however, that - as with the separate statutory privilege for tax advisors in NZ - “developments in the [Australian] common law will not necessarily affect the application of the statutory privilege, so that over time, this will inevitably result in a divergence developing between the organic common law privilege and the static statutory privilege”.<sup>157</sup> However, the ALRC felt that a separate statutory privilege could in fact be an advantage, as it would leave control of the development of the privilege in the hands of Parliament.<sup>158</sup> Under the ALRC proposal, the privilege would apply to “tax advice documents” created by an independent professional adviser who is either:

- a registered “tax agent” (most registered tax agents are accountants), or
- a nominee or employee of a registered tax agent.

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test to “dominant” purpose, but no corresponding change was ever made to the guidelines to bring them into line with this development.

<sup>150</sup> “Source” documents record transactions or arrangements entered into by a person; ATO, above fn. 146.

<sup>151</sup> ICAA, above fn. 113, Appendix C.

<sup>152</sup> Australian Law Reform Commission, *Privilege in Perspective: Client Legal Privilege in Federal Investigations* (2008), Report No 107, available at <http://www.austlii.edu.au/au/other/alrc/publications/reports/107/>. [Accessed April 25, 2010].

<sup>153</sup> ALRC, above fn. 152, Recommendation 6-6.

<sup>154</sup> ALRC, above fn. 152, at [6.278].

<sup>155</sup> Australian Treasury, above fn. 72, at [25].

<sup>156</sup> Australian Treasury, above fn. 72, at [88] – [89].

<sup>157</sup> Maples and Blissenden, above fn. 89, at 13.

<sup>158</sup> ALRC, above fn. 152, at [6.278], Australian Treasury, above fn. 72, at [28].

A “tax advice document” would be defined as a confidential document created by an independent professional accounting adviser for the dominant purpose of providing tax advice.

The privilege would not apply:

- where tax advice relates to the commission of a fraud or offence or the commission of an act rendering a person liable to a civil penalty; or
- where the person or the accounting adviser knew or ought reasonably to have known that the document was prepared in furtherance of a deliberate abuse of power,<sup>159</sup> or
- to documents, or parts of documents containing “tax contextual information”.

“Tax contextual information” - broadly equivalent to “source” documents under the current ATO accountants’ concession - would include a description of facts (including steps in carrying out the transaction) or assumptions that have occurred or are postulated, as well as advice that does not relate to the tax laws. Other types of ‘source’/tax contextual documents (e.g. a ledger or a contract) would not be covered by the privilege, even if they were given to a tax agent for the purpose of obtaining advice.<sup>160</sup>

The ALRC proposal for a tax adviser privilege has received mixed support in Australia. The Corporate Tax Association, Australian Financial Markets Association and Institute of Chartered Accountants of Australia, have indicated that they are in favour of the proposal while the Australian Securities and Investments Commission, Australian Institute of Company Directors and the Law Council of Australia have either rejected the extension of LPP beyond lawyers or raised concerns about such an extension.<sup>161</sup>

Submissions on Treasury’s Discussion Paper closed on 15 July 2011, but to date the government has not acted on the proposals.

The Australian proposals are very similar to the position in NZ, and the two regimes together (particularly as the ALRC and Australian Treasury papers consider and evaluate the NZ system) would provide useful insights if the UK were to seek to expand paragraph 25. For a more detailed consideration of the ALRC proposed tax adviser privilege see Maples and Woellner.<sup>162</sup>

## 5.2 *Insights from the NZ and Australian experience*

1. Because the NDR is a statutory creation, the New Zealand “courts have been clear that nothing will be implied that is not found in the express wording of the statute”<sup>163</sup> and accordingly there is *no* scope to extend the NDR beyond its terms. Accordingly, particular care must be taken to ensure that principles in a statutory regime like the NDR are first, clear (e.g. precisely how much protection is the regime intended to provide – equivalent to LPP – as with s 7525 in the US, discussed in Section 6 of

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<sup>159</sup> Australian Treasury, above fn. 72, at 6.

<sup>160</sup> Australian Treasury, above fn. 72, at 6.

<sup>161</sup> ALRC, above fn. 152, at [6.239].

<sup>162</sup> Maples and Woellner, above fn. 114, at 152-161.

<sup>163</sup> Keating and Campbell, above fn. 87, at 3.

this Paper - or as with the NDR, some lesser level of protection) and, second, do in fact cover their intended spheres.

2. On the other hand, creating a separate regime outside the common law means that Parliament remains (partly at least) in control of the development of the privilege (an aspect seen as desirable by the ALRC and Australian Treasury). The potential downside of this approach is that that (in the New Zealand context) the statutory privilege “will not evolve with LPP ... which means that a slow organic growth of specific case law interpreting its application and with that, its limits, will be necessary. Analogies with LPP will be likely to be of limited application.”<sup>164</sup>

However, despite the control afforded Parliament from a statutory regime, Parliament will never be able to totally control the interpretation given by courts to legislation (and the NZ courts do not seem to have been particularly sympathetic to the NDR) which in turn means that parliament will need to update the legislation from time to time (something which is easy to overlook and can be a slow process and difficult to achieve).

3. The effect of the (comparatively) clear definitions of “tax advisor” and “approved advisor group” in NZ provide relatively clear boundaries which should allay concerns such as Lloyd LJ voiced in *Prudential (CA)* that the term “accountant” would have an unacceptably vague application,<sup>165</sup> particularly when linked to the requirement that a tax adviser must belong to an approved professional body with ethical standards and sanctions for non-compliance.

4. The restriction of the NDR privilege to those documents sought by the CIR under its general information gathering powers in ss 16-19 TAA 1994 will limit the privilege to the (federal) income tax context and will not constrain the investigative powers of other agencies. This could be seen as an important policy element.

5. The requirement for the taxpayer (or their representative) to disclose tax contextual information by way of statutory declaration is a useful feature which helps protect the integrity of the non disclosure right, though there was considerable opposition to a similar proposal in the ALRC Report that claims for privilege must be “vetted” by a lawyer.

6. The exceptions to the NDR protection – particularly in relation to tax contextual information - mean that it is (by intent) considerably narrower than LPP in several dimensions and the inclusion of a US-style exception for “wrongful acts” has caused concern.

The second main alternative system which the UK and other jurisdictions might wish to consider in expanding its current protection is the US extension of LPP to certain tax advisers.

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<sup>164</sup> Keating and Campbell, above fn. 87, at 17. It will also mean that, in the event Australia and other jurisdictions adopt similar protections for tax advisers, case law in the other relevant jurisdictions on the statutory privilege will assume greater importance.

<sup>165</sup> *Prudential (CA)*, above fn. 9, [2010] EWCA 1094 at [73].

## 6. EXTENDING LPP TO NON-LAWYERS: THE US POSITION

### 6.1 Section 7525 IRC 1986

As an alternative to introducing a separate statutory regime to expand the statutory protection for tax advice provided by non-lawyers, consideration could be given to adapting the US model by extending LPP (or client-attorney privilege as it is known in the US) to selected categories of non-lawyers. Given the views expressed above by Charles J and Lloyd LJ in *Prudential*, there seems now to be a strong argument for extending to appropriately qualified tax advisers *equal* protection to that enjoyed by lawyers under LPP. However, the Australian Department of Treasury has expressed caution in this regard, observing that extending LPP to tax advisers would require further consideration of how to harmonise the different duties and ethical standards of lawyers and tax advisers, and that “further problems identified by the ALRC under the current system would be unresolved and could even expand”.<sup>166</sup>

The US model could provide some very useful comparative insights and possibilities – particularly as a number of flaws in the current regime have been identified over time, but which could easily be remedied in a new statutory adaptation.

In the US, section 7525(1) IRC 1986 (s 7525) applies the common law attorney-client privilege to a confidential communication between a taxpayer and any “federally authorized tax practitioner”,<sup>167</sup> relating to “tax advice”, but only to the extent it would have been privileged if the communication had been between a taxpayer and an attorney.<sup>168</sup>

In effect, under s 7525, the common law legal professional privilege<sup>169</sup> is extended to other tax practitioners – subject to a number of statutory and court-developed limitations which have proven highly problematic and significantly decreased the utility of the s 7525 privilege.

For these purposes, a “federally authorised tax practitioner” (FATP) is defined under s 7525(a)(3)(A) as any individual who is authorised under federal law to practice before the Internal Revenue Service (“IRS”), provided such practice is subject to federal regulation under sec 230 of Title 31 *United States Code*. “Practice before the IRS” has a broad scope, and includes preparing and filing documents, corresponding and communicating with the IRS, rendering written advice on prescribed topics (such as arrangements having a potential for tax avoidance or evasion, and representing a client at conferences, hearings and meetings).<sup>170</sup>

<sup>166</sup> Australian Treasury, above fn. 72, at [91].

<sup>167</sup> As defined in IRC 1986, s 7525(a)(3)(B)).

<sup>168</sup> See generally Joyce as to the reasons given by the US Congress for introducing the tax practitioner privilege: T.J. Joyce, “Limitations of the Attorney-Client Privilege Under Section 7525 of the Internal Revenue Code”, at 1 – 3, available at [http://www.legalinfo-panama.com/articulos/articulos\\_61a.htm](http://www.legalinfo-panama.com/articulos/articulos_61a.htm). [Accessed 2 June 2009]; and P.D. Paton “Accountants, Privilege, and the Problem of Working Papers”, 38 (2006) Issue 2 *Dalhousie Law Journal*, at 363-367.

<sup>169</sup> Joyce, above fn. 168, at 1. Pease-Wingenter observes that s 7525 IRC 1986 does not incorporate the common law distinction between pre and post-transaction tax advice: C Pease-Wingenter, “The Application of the Attorney-Client Privilege to Tax Accrual Workpapers: The Real Legacy of *United States v. Textron*” (2008) 8 *Houston Business and Tax Law Journal* 337 at 351.

<sup>170</sup> Treasury Department, The Circular 230 Deskbook, Rel #11, at [4:5]; available at [http://www.pli.edu/product\\_files/booksamples/9134\\_sample4.pdf](http://www.pli.edu/product_files/booksamples/9134_sample4.pdf). [Accessed 24 February 2012]. Treasury Department Circular No. 230 (Rev 8-2011) “Regulations Governing Practice before the IRS”: “Title 31 Code of Federal Regulations,

In turn, Treasury Department Departmental Circular 230<sup>171</sup> lists as those currently<sup>172</sup> qualified to practice before the IRS: attorneys and certified public accountants qualified to practice in any state, possessions or the District of Columbia, and (in variously limited areas)<sup>173</sup> registered tax return preparers, enrolled agents, enrolled actuaries, retirement plan agents, certain individuals (such as self-representing taxpayers, employees and others representing government and other bodies).

There are two noteworthy effects of the Circular 230 listings:

- the definition of an FATP effectively excludes most foreign tax practitioners from FATP status; and
- the scope of activities which fall within the statutory protection may vary as between different types of tax practitioners because under Circular 230, the scope of the right to practice before the IRS differs for different categories of practitioner (see above).

The second key element, “tax advice”, is also defined in convoluted terms as advice given by an individual with respect to a matter that is within the scope of their authority to practise before the IRS under Circular 230. The definition is unclear, because it does not specify whether the definition is intended to cover situations where tax advice is only a minor or minimal element in the communication with the client.<sup>174</sup>

This approach of applying the existing attorney-client privilege to tax advisers is an interesting one and has much to commend it conceptually. It will mean all the common law jurisprudence developed in relation to legal professional privilege will apply to s 7525 proceedings and continue to apply as the common law privilege develops.<sup>175</sup> As noted below, this can provide both benefits and problems.

## 6.2 Key issues arising in relation to extending privilege under section 7525

The actual operation of s 7525 has thrown up a number of problems which would need to be addressed in the UK (or another jurisdiction) if policymakers decided to adopt this approach. Indeed, while Joyce diplomatically suggests that the current pitfalls in limitations to the operations of s 7525 “impede the very purpose of the privilege: to provide the same privacy protection afforded to communications

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Subtitle A, Part 10”, (June 3, 2011) at [10.2], available at <http://www.irs.gov/pub/irs-utl/pcir230.pdf>. [Accessed 24 February 2012].

<sup>171</sup> Treasury Department Circular No. 230 (Rev 8-2011) “Regulations Governing Practice before the IRS”; [Accessed 23 February 2012]. See also Treasury Department, The Circular 230 Deskbook, Rel #11, at [4:6]; available at [http://www.pli.edu/product\\_files/booksamples/9134\\_sample4.pdf](http://www.pli.edu/product_files/booksamples/9134_sample4.pdf). [Accessed 24 February 2012].

<sup>172</sup> Circular 230 has been amended many times since its initial introduction – most recently in 2011 to add extra categories of persons entitled to practice before the IRS: C John Muller IV traces its history in C John Muller, “Circular 230: New Rules: Governing Practice Before the IRS”, 1 (2011) *St Mary’s Journal on Legal Malpractice & Ethics*, 284, at 292-294; compare with J.F. Vasquez Jr and J. Vasquez, “Section 10.35(b) of Circular 230 is invalid (but just in case it is valid, please note that you cannot rely on this article to avoid the imposition of penalties)” VII (2007) *Houston Business and Tax Law Journal*, 293 at 297, 298-303.

<sup>173</sup> For example, while attorneys and certified public accountants enjoy full rights of practice, a registered tax return preparer cannot represent a taxpayer before IRS appeals officers, revenue officers, counsel or similar IRS employees: Treasury Department, above n 170, at [10.3] (Rev 8-2011).

<sup>174</sup> Joyce, above fn. 168.

<sup>175</sup> Joyce, above fn. 168; and see R. Woellner, S. Barkoczy, A. Murphy, C. Evans, *Australian Taxation Law* 22<sup>nd</sup> ed, Sydney, CCH Australia Ltd, 2012, at 1747-1753.

between a client and their attorney”,<sup>176</sup> Smith and Kleinman suggest (along with others) that the various exceptions to the s 7525 privilege have effectively “swallowed the rule” and largely reduced s 7525 to impotence.<sup>177</sup>

Thus, while extending legal professional privilege to accountants and other tax advisers seems to have the advantage of placing lawyers and other tax advisers on a “level playing field” in this context, in fact the US experience suggests that the s 7525 privilege has generally been “construed narrowly” by US courts, with statutory limits and judicial approaches and assumptions placing<sup>178</sup> greater limitations on the availability of the privilege to accountants than to lawyers giving the same advice.

Some of these difficulties have arisen because of a conundrum inherent and embedded in the very structure of s 7525. The section has been interpreted by some US courts as meaning that only “lawyer’s” work or services are protected by s 7525, so that work and communications between a tax accountant and their client relating only to general business discussions or tax return preparation are unprotected.<sup>179</sup>

If the privilege is only to apply to the extent that it would have applied if the communication had been by a lawyer/attorney, it would seem in strict terms that any privileged advice would have to be legal in nature, because only work as a lawyer is protected by LPP/attorney-client privilege. The problem with this approach is that, as Smith observes, it “has the potential for turning the entire section 7525 privilege on its head”,<sup>180</sup> because in the US, as in a number of other jurisdictions, accountants as such are forbidden from undertaking legal work (though this is a restriction that seems observed more in the breach than the observance in many jurisdictions). Applied literally, therefore, this interpretation would totally negate s 7525 – though presumably, Congress did not intend its tax-advisers privilege to be still-born,<sup>181</sup> and must have intended it to be given a sensible interpretation - nevertheless, the wording of s 7525 poses problems.

In *United States v Frederick*, Posner CJ applied the test of whether the work was *inherently* of a non/legal nature, regardless of who actually performed it, and commented that:

“... Communications from a client that neither reflect the lawyer’s thinking nor are made for the purpose of eliciting the lawyer’s professional advice or legal assistance are not privileged. The information that a person furnishes the preparer of his tax return is furnished for the purpose of enabling the preparation of the return, not the preparation of a brief or an opinion letter. Such information therefore is not privileged”,<sup>182</sup>

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<sup>176</sup> Joyce, above fn. 168.

<sup>177</sup> D.M. Smith and D.L. Kleinman, “The Federal Authorised Tax Practitioner Privilege: What Remains Under s 7525?” (June 2006/01604) *White and Case*, 1 at 2.

<sup>178</sup> A.S. Grewal “Selective Waiver and the Tax Practitioner Privilege”, (September 25, 2006) *Tax Notes*, at 1139.

<sup>179</sup> *KPMG LLP* 2002 U.S. Dist LEXIS 24630. See the discussion in J.P. Fuller and Barton W.S. Bassett, “International Tax Controversies – *KPMG LLP*: Highlighting the Limits of the Accountant-Client Privilege of Code Sec. 7525 and Important Implications Concerning the Sarbanes-Oxley Act of 2002”, (2003-2004) 3 *J. Tax’n Global Transactions* 17, at 18-19, 20; D. J. Bennett, “*Textron Inc*: A Privileged Position” (2007) 85 *Taxes* 7, at 9.

<sup>180</sup> R.T. Smith, “After the Alamo: Taxpayer Claims of Privilege – the IRS War on Tax Shelters”, (January 13, 2003) *Tax Notes*, at 233 – quoted by Grewal, above fn. 178, at 1149.

<sup>181</sup> Grewal, above fn. 178, at 1149.

<sup>182</sup> 182 F.3d, 496, 500 (7<sup>th</sup> Cir. 1999), quoted by Grewal, above fn. 178, at 1141.

and

“...a taxpayer must not be allowed, by hiring a lawyer to do the work that an accountant, or other tax return preparer, or the taxpayer himself or herself, normally would to, obtain greater protection from governmental investigators than a taxpayer who did not use a lawyer as his tax preparer ... The information that a person furnishes the preparer of his tax return is furnished for the purpose of enabling the preparation of the return, not the preparation of a brief or an opinion letter. Such information therefore is not privileged”.<sup>183</sup>

Grewal concludes that the US courts overall have not applied a “legal advice” test, but rather “have insisted that the attorney-client’s confidentiality requirement apply”.<sup>184</sup> As Joyce notes,<sup>185</sup> that s 7525 IRC 1986 does not clarify whether ‘tax advice’ includes providing legal advice, has meant that accounting firms and other non-attorney practitioners have faced the “ominous task” of trying to clarify the fine line between legal advice and tax advice”.<sup>186</sup>

Smith and Kleinman identify 8 limitations on s 7525 which together “swallow the rule” – i.e. substantially erode s 7525’s effectiveness. For the purposes of this Paper the main exceptions are (in addition to whether s 7525 applies to “lawyers” work):

#### 6.2.1. *The privilege is excluded in relation to certain corporate tax shelters*

The privilege does not apply to *written* communications between a “federally authorised tax practitioner” and any “person”<sup>187</sup> *in connection with* the promotion of the in/direct “participation of the person in *any tax shelter*”.<sup>188</sup>

This exclusion only applies to remove the s 7525 privilege where three cumulative criteria are met – there must be a communication<sup>189</sup> which is:

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<sup>183</sup> 182 F3d 496, 500 (7<sup>th</sup> Cir 1999)]; cf *United States v Gurtner* 474 F.2d, 297 (9<sup>th</sup> Cir 1973); *United States v Cote* 456 F.2d 142 (8<sup>th</sup> Cir 1972) – though some courts have held that communications about what to claim in a tax return could be legal advice: *United States v Abrahams* 90-1 US Tax Cas 50,310 (9<sup>th</sup> Cir 1990), cf *Colton v United States* 306 F.2d 633 (2d Cir 1962).

<sup>184</sup> Grewal, above fn. 178, at 1150 – though Grewal argues (at 1151-52) that even this confidentiality requirement is “misguided”. And the courts should apply a doctrine of selective waiver.

<sup>185</sup> Joyce, above fn. 168.

<sup>186</sup> Compare the ALRC Report: ALRC, above fn. 152, at [6.215], and Pease-Wingenter, above fn.169, at 699.

<sup>187</sup> The term “person” includes any director, officer, employee, agent or representative of, or person holding a capital or profits interest in, the person: IRC 1986, s. 7525(3)(b)(1)(A), (B), (C).

<sup>188</sup> IRC 1986 s. 7525(3)(b)(2). The “tax shelter” provision is a genuine exception to the general rule, so that the IRD bears the burden of proving that the “exception” applies to exclude the privilege: *United States v BDO Seidman* 337 F.3d 802 (7<sup>th</sup> Cir. 2003) (*BDO Seidman*).

<sup>189</sup> In *Countryside Ltd Partnership et al v Cer* 132 T.C. No.17 (2009), at 7-8 (*Countryside Ltd Partnership*), Halpen J in the Tax Court held that two pages of handwritten notes which had been made by a partner in an accounting firm of a confidential meeting between with the FATP were not a “written communication” because they merely recorded oral advice given during the meeting and were not “communicated” to any other person. Smith and Kleinman express concern that it is unclear whether the exception applies only to written marketing materials, or covers all written advice regarding tax shelters. In the latter case, the exception “could conceivably cover any written advice intended to reduce the amount of federal income tax ... and a transaction can be a tax shelter even if it has economic substance”: Smith and Kleinman, above fn. 177, at 2.

- (i) written (hence an oral communication about a tax shelter will still be protected by the privilege);<sup>190</sup>
- (ii) between a “federally authorised tax practitioner” (discussed above) and any “person” (as defined above); and
- (iii) in connection with the promotion<sup>191</sup> of “in/direct participation in a tax shelter”.

A “tax shelter” is defined for these purposes in s 6662(d)(2)(C)(ii) as any entity, investment or other plan or arrangement which has “a significant purpose”<sup>192</sup> of avoiding or evading Federal income tax.<sup>193</sup> In *Textron* the court held that the “tax shelter” exception was aimed at communications by external tax practitioners attempting to sell tax shelters to a corporate client.<sup>194</sup> However, the definition is extremely broad, covering “far more than what is typically thought of as a tax shelter”,<sup>195</sup> and not all courts have taken the narrow view of the exception articulated in *Textron*.<sup>196</sup>

While in order to be a “tax shelter” the significant purpose must be to avoid or evade the *Federal* income tax (so that arrangements to avoid or evade *State* taxes are not caught by the definition), the breadth of the definition of “tax shelter” means that it might be thought to cover *all* tax planning advice, since the aim of tax planning is usually to minimise Federal tax.<sup>197</sup> Moreover, the test does not require a “dominant” or “main” purpose of tax avoidance or evasion, but instead the lesser test of “*any significant*” purpose (emphasis added). No elaboration is provided on the meaning of this qualifier.<sup>198</sup>

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<sup>190</sup> *BDO Seidman*, above fn. 188, 337 F.3d 802 (7<sup>th</sup> Cir. 2003).

<sup>191</sup> The term “promotion” is broad and encompasses any plan or arrangement whose significant purpose is to avoid or evade federal taxes: *Valero Energy Corp v United States* 569 F.3d 626 (7<sup>th</sup> Cir 2009) (*Valero Energy*). However, it does not include the passive transmission of information, and only applies to future transactions, not those which have already taken place: *United States v Textron Inc and Subsidiaries* 507 F Supp 2d 138 (D RI 2007)]; *Countryside Ltd Partnership*, above fn. 189, T.C. No.17 (2009).

<sup>192</sup> Not merely an ancillary purpose: *Valero Energy*, above fn. 191, 569 F.3d 626 (7<sup>th</sup> Cir 2009). However, there is no clear definition of “significant purpose”, and the IRS has indicated that it does not propose to clarify the point.

<sup>193</sup> IRC 1986 s. 6662(d)(2)(C)(iii), as amended by the Taxpayers Relief Act 1997 (US).

<sup>194</sup> Echoing the view of Senator Mack in moving the introduction of s 7525 (of taxpayer protection): K Kendall, “Designing Privilege for the Tax Profession: Comparing I.R.C. s 7525 with New Zealand’s Non-Disclosure Right”, (July 2010), available at [http://works.bepress.com/cgi/viewcontent.cgi?article=1002&context=keith\\_kendall&seidir=1&referer=http%3A%2F%2Fwww.google.co.nz%2Furl%3Fsa%3Dt%26rct%3Dj%26q%3Dsenator%2520mack%25207525%26source%3Dweb%26cd%3D1%26sqi%3D2%26ved%3D0CCEQFjAA%26url%3Dhttp%253A%252F%252Fwork.s.bepress.com%252Fcgi%252Fviewcontent.cgi%253Farticle%253D1002%2526context%253Dkeith\\_kendall%26ei%3DQ79GT4yGGKHUmAW6ye2mDg%26usg%3DAFQjCNEwXf5c9A7sf645Q04jAizvCMD9g#search=%22senator%20mack%207525%22](http://works.bepress.com/cgi/viewcontent.cgi?article=1002&context=keith_kendall&seidir=1&referer=http%3A%2F%2Fwww.google.co.nz%2Furl%3Fsa%3Dt%26rct%3Dj%26q%3Dsenator%2520mack%25207525%26source%3Dweb%26cd%3D1%26sqi%3D2%26ved%3D0CCEQFjAA%26url%3Dhttp%253A%252F%252Fwork.s.bepress.com%252Fcgi%252Fviewcontent.cgi%253Farticle%253D1002%2526context%253Dkeith_kendall%26ei%3DQ79GT4yGGKHUmAW6ye2mDg%26usg%3DAFQjCNEwXf5c9A7sf645Q04jAizvCMD9g#search=%22senator%20mack%207525%22). [Accessed 24 February 2012].

<sup>195</sup> D.T. Moldenhauer, “Circular 230 Opinion Standards, Legal Ethics and First Amendment Limitations on the regulation of Professional Speech by Lawyers”, 29 [2006] *Seattle University Law Review* 843, at 849-50; cf D.N. Brager, C. Cobb, K. Dellinger and W. Quealy Jr, “Circular 230: An Overview” (Dec 2005-Jan 2006) *Jnl of Tax Practice & Procedure*, 33 at 34.

<sup>196</sup> Indeed, Lynam, above, argues that the s 6663(d) IRC 1986 definition is potentially so broad that it includes any plan or arrangement that has as a significant purpose the avoidance of federal income tax - “In other words, all tax planning”: G.S. Lynam, “Why the Work of In-House Accountants is NEVER subject to the Tax Practitioner Privilege of s 7525”, (June 20, 2008) *Ferraro Law Firm circular*, available at <http://www.ferrarolaw.com/>. [Accessed 24 February 2012].

<sup>197</sup> Vasquez and Vasquez, above fn. 172, at 297; Lynam, above fn. 196.

<sup>198</sup> Kendall, above fn. 1, at 394.



The term “promotion” is not defined and while in *Countryside Ltd Partnership*, Halpen J in the Tax Court held that “promotion” did not include “routine” tax advice given by a tax practitioner and their client;<sup>199</sup> “the exact boundaries are inherently difficult to specify.”<sup>200</sup>

When combined with the broad concept of communications which are *in/directly* in “connection with participation” (emphasis added), this exception seems likely to have a broad scope,<sup>201</sup> and therefore likely to exclude a wider range of circumstances from the protection of the privilege.<sup>202</sup> Indeed, the “tax shelter” exception has been described as “the exception that swallows the rule”.<sup>203</sup>

The NDR does not contain a “tax shelter” type exception, instead a “tax advice document” excludes documents created for *inter alia* committing a wrongful act – which, as discussed, has itself caused some concern as to its potential broad application. The decision of the ALRC not to suggest inclusion of this type of exception in any future Australian regime also seems understandable, particularly given the general anti-avoidance provisions in Part IVA Income Tax assessment Act 1936 (CTH) (ITAA 1936).<sup>204</sup> However, it is worth considering as a useful precedent for the UK – though the drafting would need to be sharper and more clearly focused than s 7525.

### 6.2.2. Identity privilege

The US courts have in practice generally denied protection of the client’s identity from disclosure. The Seventh Circuit Court in *BDO Seidman*<sup>205</sup> had held that s 7525 protection would be attracted where, by reference to the relevant factors, “so much of an actual confidential communication has been disclosed already that merely identifying the client will effectively disclose that communication”.<sup>206</sup> This is consistent with the position in relation to common law LPP.<sup>207</sup>

Despite this theoretical position, Smith and Kleinman suggest that since the *BDO Seidman* decision, “courts have either applied the *BDO Seidman* factors and found that no statutory privilege exists or concluded that *BDO Seidman* stood for the proposition that no identity privilege exists at all”.<sup>208</sup>

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<sup>199</sup> 132 T.C. No.17 (2007). Lynam, above fn. 196, may overstate the case when he argues than argues that “promotion” in this context could cover any activity engaged in by an accountant in relation to a tax shelter.

<sup>200</sup> Kendall, above fn. 1, at 395.

<sup>201</sup> The scope of the Australian exception is discussed in Woellner, Barkoczy, Murphy and Evans, above fn. 175, at 1753.

<sup>202</sup> T. LeBlanc, “Accountant-Client Privilege: The Effect of the *IRS Restructuring and Reform Act of 1998*” 67 (1999) *University of Missouri at Kansas City Law Review* 583, at 596; K. Kendall, “Prospects for a Tax Advisors’ Privilege in Australia” 1 (2005) Issue 3 *Journal of the Australasian Tax Teachers Association* 46, at 58. In *BDO Seidman* the court noted that the tax shelter exception overrides the principle that LPP is not excluded by disclosure to a third party if the purpose of the disclosure is to have an expert assist with the provision of confidential advice.

<sup>203</sup> Joyce, above fn. 168.

<sup>204</sup> ITAA 1936 s. 177A-177H (Cth).

<sup>205</sup> *BDO Seidman*, above fn. 188, 337 F.3d 802 (7<sup>th</sup> Cir. 2003).

<sup>206</sup> *BDO Seidman*, above fn. 188, 337 F.3d 802 (7<sup>th</sup> Cir. 2003), at 811.

<sup>207</sup> To this effect in Australia, see *Coombes*, above fn. 136, 99 ATC 4634 at 4643; see also *Deloitte Touche Tomatsu & Ors v DFC of TY 98* ATC 5192 at 5203-11.

<sup>208</sup> Smith and Kleinman, above fn. 177, at 3 – citing *US v Arthur Andersen* 92 A.F.T.R. 2d 746 (N.D. Tex. 2004) and *Doe I & 2 v KPMG* 325 F. Supp. 2d 746 (N.D. Tex 2004).

### 6.2.3. Criminal matters, federal agencies and waiver

#### *Non-criminal tax matters only*

The s 7525 privilege can only be asserted in ***non-criminal***:

- (i) tax matters before the IRS, or
- (ii) tax proceedings in a Federal court brought by or against the US.<sup>209</sup>

Limiting the privilege to non-criminal tax matters is significant, because the IRC 1986 provides for a wide range of criminal offences, and the IRS can choose whether to initiate a civil or criminal action (or convert a civil to a criminal action sharing similar elements. The potential therefore exists for the IRS to be able to avoid the protection of s 7525 simply by choosing to run a matter as a criminal action.<sup>210</sup>

This limitation is significant also because there is an argument that the statutory protection is entirely lost ab initio once an action which begins as a civil matter is subsequently converted to a criminal matter,<sup>211</sup> i.e. the privilege dissolves retrospectively, and communications that were previously privileged lose that protection and then become accessible to the IRS. The situation is exacerbated by the fact that it lies in the IRS' hands to determine when and whether to escalate a matter into the criminal sphere and identifying the moment when a matter "transforms" from civil in character to criminal can involve considerable difficulty.<sup>212</sup> This raises the possibility of abuse - though such decisions presumably are not taken lightly and would have to be taken bona fide to avoid the taxpayer raising a "malfeasance in public office" action or its equivalent.<sup>213</sup>

The absence of privilege for accountants in this situation, and the uncertainty as to when a matter may move into the criminal sphere could cause some advisers to refer clients to lawyers when matters involving privilege potentially arise, such as the failure by the client to file a tax return or pay their taxes.<sup>214</sup> And, as in Australia, US legal firms have actively marketed this advantage. Certainly in this respect at least, s 7525 has failed to put accountants on an equal footing with lawyers.

The IRS could also sidestep the protection of s 7525 by collaborating with another Federal agency (such as the Securities and Exchange Commission (SEC)) and arranging for the other body to require production of the relevant documents. Section 7525 protection does not apply to the SEC requirement, because it is limited to matters before the IRS. Once the document has been produced to the SEC or other body, the IRS can also access them as the courts have generally not applied a doctrine of selective

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<sup>209</sup> IRC 1986 s 7525(2)(A), (B).

<sup>210</sup> Joyce, above fn. 168.

<sup>211</sup> The IRC Chief Counsel stated in 2000 that (in his view) the privilege will not apply "even if a subject communication originated in the context of a civil matter or proceeding" – i.e. the privilege will "evaporate retrospectively": Smith and Kleinman, above fn. 177, at 5. See also Joyce, above fn. 168, at 3-4.

<sup>212</sup> Joyce, above fn. 168.

<sup>213</sup> For example, in Australia "conscious maladministration": see *FC of T v Futuris Corporation Ltd* 2008 ATC 20-039 (majority).

<sup>214</sup> V. Jacobs, "Limits on Client Confidentiality and the Accountant-Client Privilege" as cited in Kendall, above fn. 202, at 60 – though the ALRC found no hard evidence that the disparity in protection had had this effect.

waiver (discussed below). Presumably a federal body will not automatically accede to such a request from the IRS, but the potential remains.

### *Waiver of the s 7525 privilege*

Because the statutory s 7525 privilege imports the common law privilege, the common law principles relating to waiver of the privilege will apply. Waiver of privilege by disclosure to third parties which applies to LPP (client-attorney) communications in the USA and Australia is comparatively broad,<sup>215</sup> encompassing express and implied waiver<sup>216</sup> and by “importing the entire common law of the attorney-client privilege in tax matters ... the [result is that the s 7525] privilege can be easily waived” by such disclosure.<sup>217</sup> This is given added importance because few US courts have been willing to apply a “selective waiver” doctrine which would hold that disclosure to the federal government (e.g. the SEC) does not waive privilege for other purposes (e.g. production to the IRS).<sup>218</sup>

By contrast, the doctrine of waiver applying under the US work product doctrine (discussed in Section 6.3 of this Paper) is narrower, focussing instead on the likelihood of disclosure to adversarial parties.<sup>219</sup> Accordingly the work-product privilege may continue to provide protection while on the same facts, legal professional (attorney-client) privilege may be held to have been waived. This raises a policy issue as to the proposed scope of the waiver doctrine – and whether a broader waiver doctrine might be appropriate for a “model” system.

To minimise potential problems with this “escalation” issue, taxpayers may be tempted to hire a lawyer to provide advice as soon as the possibility emerges that a matter could potentially escalate into a criminal action – again conferring a marketing advantage upon lawyers.

There is no similar general limit to non-criminal matters in the ALRC proposal or New Zealand regime, and there would seem to be a strong argument that any adaptation to an “ideal” model should follow NZ and Australia on this issue, rather than the US.

#### *6.2.4. State actions*

A similar potential problem arises in relation to the limitation of the privilege to actions by the IRS or proceedings in a federal court. The s 7525 privilege can only be pleaded in a non-criminal action in a Federal Court or where the action is brought by or against the United States – it therefore does not apply to proceedings involving state agencies or federal agencies other than the IRS - such as the Federal Trade Commission or SEC.<sup>220</sup>

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<sup>215</sup> M.J. McMahon and I.B. Shepard, “Privilege and the Work Product Doctrine in Tax Cases” 58 (2004) *Tax Lawyer* 405 at 418.

<sup>216</sup> See Woellner, Barkoczy, Murphy, and Evans, above fn. 175.

<sup>217</sup> J. Newman, “*Tax Practice and Privilege: A Tale of Two Countries*”, (March 2003) Wake Forest University School of Law, *Public Law and Legal Theory Research Paper Series* (Research Paper No.03-04), at 7.

<sup>218</sup> Grewal, above fn. 178, at 1140; “... the selective waiver doctrine has received a cool reception in the federal courts. Most courts have summarily rejected it ...” cf A.S. Grewal, “Section 7525’s Last Gasps: The Tax Practitioner Privilege and the Selective Waiver Doctrine”, *BePress Legal Services* 2006, Paper 1691, at 2.

<sup>219</sup> A.E. Sadler, “Tax Advice As Work Product: The Scope of Work Product Protection in Tax Shelter Controversies” (2004) 13 *Journal of Tax Practice and Procedure*, at 14.

<sup>220</sup> IRC 1986 s 7525(a)(2)(B).

Because the s 7525 privilege only protects communications about tax before the IRS or in a Federal Court, it does not protect communications from compulsory disclosure in state proceedings,<sup>221</sup> which may constitute a waiver of the privilege.<sup>222</sup> This waiver may also occur as a result of proceedings pursued by another government agency, such as the SEC.<sup>223</sup>

As discussed in Section 5 of this Paper, the proposed Australian protection is much broader in this respect and arguably more consistent with its underpinning policy rationale. The Australian approach might therefore be a better precedent for the model legislation than the US version.

#### 6.2.5. *Other exceptions*

Smith and Kleinman also refer to a number of other exceptions<sup>224</sup> (not dealt with here) which contribute to the erosion of s 7525's effectiveness, namely:

- Sec 7525 does not incorporate the “work-product” doctrine (which is dealt with in the following section of this Paper);
- the crime-fraud exception; and
- auditor communications.

While s 7525 was soundly based conceptually,<sup>225</sup> its actual operation has demonstrated a number of weaknesses in its structure and drafting. Indeed, the impact of the various limits on s 7525 led McMahon and Shepard to conclude that its protection is “far narrower” than LPP,<sup>226</sup> while Kaplan concludes that the various exceptions to s 7525 have left the privilege with “more holes than Swiss cheese”.<sup>227</sup> Ironically, however, s 7525's various flaws provide very useful guidelines for those seeking to develop a more effective instrument for the future.

### 6.3 *The United States hybrid “Work Product” Doctrine*

While most analyses have concentrated on the US attorney-client privilege, it is worth examining briefly the US “work product” doctrine, as it contains some useful lessons for those contemplating a review of the UK provisions.

#### 6.3.1 *Background*

In addition to the specific statutory protection in s 7525 IRC 1986, tax advisors in the US can also in appropriate circumstances seek protection under the “work-product” doctrine.

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<sup>221</sup> Kendall, above fn. 202, at 58; Kendall, above fn. 1, at 388-9.

<sup>222</sup> LeBlanc, above fn. 202, at 594.

<sup>223</sup> Kendall, above fn. 202, at 58.

<sup>224</sup> Smith and Kleinman, above fn. 177, at 2-4.

<sup>225</sup> McMahon and Shepard, above fn. 215, at 416.

<sup>226</sup> McMahon and Shepard, above fn. 215; S.Z. Kaplan, “Privilege Meets Transparency: Can We Practise Safe Tax?” 58 (2006) *The Tax Executive* 206, at 208-09.

<sup>227</sup> Kaplan, above fn. 226, at 208-209.

This doctrine was established by the common law in the 1947 Supreme Court decision in *Hickman v Taylor*.<sup>228</sup> Somewhat colourfully, Judge Richard Posner in *United States v Frederick*<sup>229</sup> characterised the doctrine as:<sup>230</sup> “... intended to prevent a litigant from taking a free ride on the research and thinking of his opponent’s lawyer and to avoid the resulting deterrent to a lawyer’s committing his thoughts to paper”.

The work product doctrine was partly codified in Rule 26(b)(3) of the Federal Rules of Civil Procedure,<sup>231</sup> and defined in the Restatement (paragraph 87) as protecting:

- “fact work product” (or “ordinary” work product);<sup>232</sup> namely work product that is the result of fact finding undertaken in order to prepare for litigation. This “fact product” has qualified protection, in that under Rule 26(b)(3)(A)(ii) of the Federal Rules of Civil Procedure the other party can seek to discover the documents as long as they can show “substantial need for the materials to prepare [their] case and cannot, without undue hardship, obtain their substantial equivalent by other means.” By contrast,
- “opinion work product”; which protects “the mental impressions, conclusions, opinions or legal theories of an attorney or other representative of a party concerned in the litigation”,<sup>233</sup> has traditionally been given a far higher level of protection by the courts,<sup>234</sup> and is “virtually absolute”.<sup>235</sup>

The key threshold element required to attract the protection of the work-product doctrine is that the document is prepared “in anticipation of litigation”. The US Circuit courts had, up to the decision in *United States v Textron Inc.*<sup>236</sup> (where the First Circuit Court applied a “for use” in litigation test) - generally interpreted this phrase broadly and applied a “because of” test, which asked whether the tax advisor’s motive in preparing the document was “because of” the prospect of litigation,<sup>237</sup> rather than

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<sup>228</sup> *Hickman v Taylor* 329 US 495, 67 S Ct 385 (1947); see A. Golodny, “Lawyers Versus Auditors: Disclosure to Auditors and Potential Waiver of Work-Product Privilege in *United States v Textron*”, 61 (2007-2008) *Tax Lawyer* 621, available at [http://heinonline.org/HOL/Page?handle=hein.journals/txlr61&div=25&g\\_sent=1&collection=journals](http://heinonline.org/HOL/Page?handle=hein.journals/txlr61&div=25&g_sent=1&collection=journals). [Accessed 22 February 2012].

<sup>229</sup> *United States v Frederick*, 182 F.3d 496 (7<sup>th</sup> Cir. 1999) (*Frederick*). Note also the US Supreme Court in *U.S. v Nobles*, 422 US 225, 238; 95 S Ct 2160 (1975) - quoted in A.E. Sadler, “Tax Advice As Work Product: The Scope of Work Product Protection in Tax Shelter Controversies” 13 (2004) *Journal of Tax Practice and Procedure*, at 14.

<sup>230</sup> Judge Posner in *Frederick*, above fn. 229, 182 F.3d 496, 500 (7<sup>th</sup> Cir. 1999) – quoted by Golodny, above fn 228, p 622. In *U.S. v Nobles*, 422 US 225, 238; 95 S Ct 2160 (1975), the US Supreme Court observed more prosaically that the doctrine “shelters the mental processes of the attorney, providing a privileged area within which he can analyse and prepare his client’s case” – quoted in Sadler, above fn. 229, at 14. ; cf *SABA Partnership v Cer* 78 T.C.M. (CCH) 684, 1999 T.C.M. (RIA), at [99,359]; *Hambarian v Cer* 118 T.C. 565 (2002) – discussed in McMahon and Shepard, above fn. 215, at 432-33. M.M. Henkel, “The Pursuit of Transparency Does Not Trump the Work Produce Privilege” 60 (May-June 2008) *Tax Executive*, 175, at 176-177, HeinOnline. [Accessed 11 May 2009].

<sup>231</sup> Rule 26(b)(3)(A) Federal Rules of Civil Procedure (US); see Golodny, above fn. 228, at 622.

<sup>232</sup> Restatement, para 87.

<sup>233</sup> Rule 26(b)(3)(B) Federal Rules of Civil Procedure (US).

<sup>234</sup> Kendall observes that: “The standard required to be met for disclosure to occur is notoriously difficult to attain”: Kendall, above fn. 1, at 370.

<sup>235</sup> Sadler, above fn. 229, at 14. The protection is only lost where the mental impressions of the attorney are at issue in the proceedings.

<sup>236</sup> *United States v Textron Inc.*, Dkt, No. 07-2631 (1<sup>st</sup> Cir. August 13, 2009).

<sup>237</sup> Sadler, above fn. 229, citing the leading case of *M Adlman (Adlman II)* CA-2, 98 USTC 50,230, 134 F3d, 1499-1500; compare McMahon and Shepard, above fn. 215, at 430-31.

focussing on the mere degree of temporal proximity of litigation.<sup>238</sup> Accordingly, it was often<sup>239</sup> a comparatively simple matter to satisfy the work product doctrine in relation to documents prepared once a taxpayer is involved in litigation.<sup>240</sup>

The work product doctrine could also apply to protect tax advice given before litigation has commenced, “so long as the prospect of litigation supplied part of the taxpayer’s motivation for obtaining the advice” *M Adlman*<sup>241</sup> – even though it was not protected by attorney-client privilege.<sup>242</sup>

It has been held that the fact that a document has been prepared - even primarily - for another purpose (e.g. to assist in the making of a business decision)<sup>243</sup> does not necessarily prevent the work product protection from applying.<sup>244</sup> However, documents that are prepared “in the ordinary course of business or that would have been created in essentially similar form irrespective of litigation”<sup>245</sup> are not protected, nor is tax return preparation or accounting work as such.<sup>246</sup> Nevertheless, Kendall suggests that US courts overall: “have demonstrated a greater willingness to allow accounting work papers to be covered by the work product doctrine”.<sup>247</sup>

### 6.3.2 *The work product waiver exclusion*

As noted earlier, the scope of the waiver exclusion applying to the work-product doctrine is narrower than that applying to the client attorney privilege. Whereas legal privilege can be waived by disclosure to any third party, waiver of the work product doctrine will only occur where the disclosure has made it more likely that the communication could become accessible to persons who are in a “tangible” adversarial relationship to the taxpayer.

This is illustrated by the lower court decisions in *Textron*,<sup>248</sup> where the company had revealed to its auditor, Ernst and Young, work papers containing information about “questionable” positions taken by the company on various tax issues. The District Court found that, while the attorney-client and tax-practitioner privilege had indeed been waived by the disclosure, the work product doctrine had not. In reaching this conclusion, the court relied on its view that the rationale for the protection of the work

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<sup>238</sup> Sadler, above fn. 229, at 17. Fuller and Bassett note that courts generally require that the adviser had a subjective belief that litigation is a real possibility, and that this belief be objectively reasonable: Fuller and Bassett, above fn. 179, at 20.

<sup>239</sup> Golodny, above fn. 228, at 623 notes that “Under this [because of] test, it is much more difficult for the [IRS or other] requesting party to gain access to documents like tax workpapers, because by their very nature such documents contemplate litigation even if their ‘primary purpose’ is for some other business reason”.

<sup>240</sup> Sadler, above fn. 229, at 15.

<sup>241</sup> Sadler, above fn. 229 – citing *M. Adlman*, 68 F3d, at 1499-1501 (*Adlman I*); *Adlman II*, above fn 237, CA-2, 98 USTC 50,230, 134 F3d at 1195-98; Henkel, above fn. 230, at 177-78; Kaplan, above fn. 226, at 209-210;

<sup>242</sup> Established in *M Adlman*, above fn. 241, 68 F3d at 1499-1501; and confirmed in *Long-Term Capital Holdings*, DC Conn., 2003-1 USTC 50,304; *Long-Term Capital Holdings*, DC Conn., 330 FSupp 2d 122 (2004); *Black and Decker Corporation*, DC Md., 2003-2 USTC, 50,659, 219 FRD 87.

<sup>243</sup> Golodny, above fn. 228, at 623.

<sup>244</sup> Sadler, above fn. 129, at 15-16; *Long-Term Capital Holdings*, DC Conn., 2003-1 USTC 50,304; *Long-Term Capital Holdings*, DC Conn., 330 FSupp 2d 122 (2004); *Black and Decker Corporation*, DC Md., 2003-2 USTC, 50,659, 219 FRD 87. See Sadler, above fn. 229, at 17 for further details on these cases.

<sup>245</sup> Golodny, above n 228, at 628; McMahon and Shepard, above fn. 215, at 431; compare *United States v Textron Inc.* 507 F. Supp. 2d 138 (DRI 2007) at [13-41], [51-61] (*Textron*).

<sup>246</sup> *Frederick*, above fn. 229, 3d 496 (7<sup>th</sup> Cir. 1999); *United States v Arthur Young & Co.*, 465 US 805(1984); McMahon and Shepard, above fn. 215, at 433-34; Kaplan, above fn. 226, at 208-09.

<sup>247</sup> Kendall, above fn. 1, at 377.

<sup>248</sup> *Textron*, above fn. 245, 507 F. Supp. 2d 138 (DRI 2007).

product doctrine is to “prevent another party from obtaining an unfair advantage by gaining access to documents prepared in anticipation of litigation that could reveal a strategy or assessment of the strengths and weaknesses of a case”.<sup>249</sup> On the facts in *Textron*, the relationship between Ernst and Young and Textron was held not to be a “tangible adversarial relationship”<sup>250</sup> of the type required for a waiver of the work-product protection.<sup>251</sup>

While the decisions in the *Textron* case at various levels have been criticised from all sides,<sup>252</sup> the concept of a “tangible adversarial relationship” as the basis for waiver is one worth considering with the appropriate adaptations, for a model system.<sup>253</sup>

However, on appeal, at the request of the IRS, the original First Circuit judgement in the case was vacated,<sup>254</sup> and in a controversial<sup>255</sup> 3-2 split decision, the First Circuit<sup>256</sup> then ruled that the work product doctrine does not protect a company’s tax accrual work papers from IRS discovery because they are independently required by statutory and audit requirements applicable to every company that files audited financial statements for the SEC. There was no evidence that they were prepared “for use” in litigation.

The case has important work product implications because the First Circuit review majority did not use the “because of” standard, instead preferring the more restrictive “for use” in litigation standard.<sup>257</sup>

And on 24 May 2010, the Supreme Court en banc declined to hear *Textron’s* appeal from the First Circuit decision, leaving the more restrictive First Circuit “for use in” litigation test standing. To date there does not appear to have been a legislative response to “rescue” s 7525.

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<sup>249</sup> *Textron*, above fn. 245, 507 F. Supp. 2d 138 (DRI 2007) at [41] – Bennett, above fn. 179, at 10. See, for example *United States v Massachusetts Institute of Technology*, 129 F.3d 681, discussed by Kaplan, above fn. 226, at 208 and *Long-Term Capital Holdings*, DC Conn., 2003-1 USTC 50,304; *Long-Term Capital Holdings*, DC Conn., 330 F.Supp 2d 122 (2004); and *Black and Decker Corporation*, DC Md., 2003-2 USTC, 50,659, 219 FRD 87 – each cited in Sadler, above n 229, at 16-17 (notes 26, 34); Golodny, above fn 228, at 629; Henkel, above fn. 230, at 179-180.

<sup>250</sup> Golodny, above fn. 228, at 632-34, 636, citing *Merrill Lynch v Allegheny Energy Inc* 229 F.R.D. 441, 447.

<sup>251</sup> The IRS also argued, equally unsuccessfully, that the fact that the IRS might be able to subpoena Textron or its auditors to produce the documents, Textron must be taken to have waived the work-product privilege: *Textron*, above fn. 245, 507 F. Supp. 2d 138 (DRI 2007) at [44-50].

<sup>252</sup> Criticising the decision for creating uncertainty in the waiver doctrine: J.A. Pawlow and K. Spencer, “Adrift in a Sea of Uncertainty: Tax Accrual Workpapers Are Work-Product ... But Showing Them to Your Auditor May Waive the Protection”, 61 (2009) *Tax Executive* 33. Contrast the criticisms that the decision inappropriately favoured privilege over transparency levied by Pease-Wingenter, above fn. 169; D.J. Ventry, “Protecting Abusive Tax Avoidance” 120 (2008) *Tax Notes* 857. Compare this with Henkel who states that “these cases represent an emerging line of authority holding that the work product privilege is alive and well in the tax world and that this privilege can protect critical documents from disclosure to the IRS and other tax authorities.”: Henkel, above fn. 230, at 175.

<sup>253</sup> Pease-Wingenter, above fn. 169; Ventry, above fn. 252.

<sup>254</sup> *United States v Textron Inc.*, 560 F.3d 513 (1st Cir. 2009).

<sup>255</sup> H J Lager, “U.S. v. Textron: IRS Is Entitled to Tax Accrual Work Papers” (8 September 2009) *LawUpdates.com* available at <http://www.lawupdates.com/print/>, accessed 12 March 2010.

<sup>256</sup> *United States v Textron Inc.*, Dkt. No. 07-2631 (1<sup>st</sup> Cir., August 13, 2009).

<sup>257</sup> See S. Shanahan, “Tensions Are Rising from IRS Victory in Textron Case” (24 November 2009) *WebCPA*, available at <http://www.webcpa.com/news/Tensions-Rising-IRS-Victory-Textron-Case-52538-1.html>. [Accessed 12 March 2010], and Mayer Brown, *US First Circuit changes Course in Textron; Holds Tax Accrual Workpapers Are Not Protected After All* (17 August 2009), available at [www.mondaq.com/unitedstaes/article.asp?articleid=84808](http://www.mondaq.com/unitedstaes/article.asp?articleid=84808). [Accessed 13 March 2010].

#### 6.4 Insights from the US experience

As already acknowledged, s 7525 has been the subject of much criticism. The protection afforded by s 7525 has been described as “far narrower” than legal professional privilege,<sup>258</sup> and the various exceptions contained in the section have left it with “more holes than Swiss cheese”.<sup>259</sup> However, and somewhat perversely, the flawed US experience with s 7525 and the diminished work product doctrine (post *Textron*) provide a rich set of useful insights which could help guide the creation of a model tax adviser privilege for the UK or other jurisdictions.

As a general observation, the concept of importing the common law into the tax adviser’s privilege is a fundamentally sound one – provided the policy implications of such a move are understood and addressed adequately. After all, in theory at least, the wording in s 7525 should ensure that there is a direct correlation between the development of the law of LPP and s 7525 – rather than the potential for divergence likely where there is a separate statutory privilege for tax advisers (as in NZ). The “failure” of s 7525 reflects the flaws in the road rules – its structure and drafting - more than the vehicle.

There are a number of aspects of s 7525 which would need rectification if it were to be introduced into an “ideal” system, whether in the UK or elsewhere. In particular:

1. Arguably the most important lesson from the US experience is the need for policy-makers to decide *precisely* how much privilege they intend to give to tax advisers, and then introduce clear provisions to achieve this.
2. In creating an ideal statutory regime, significant policy issues must be addressed. Much of the confusion and ineffectiveness of s 7525 has flowed from the fundamental conundrum which was not directly addressed – if accountants and other non-lawyer tax advisers are not permitted to conduct “legal work”, how do they fit within a regime which imports the common law legal professional privilege principles which are addressed to work performed “as a lawyer”?

It would certainly be possible to address this issue – e.g. by:

- expressly permitting tax advisers to provide privileged tax assistance and advice on legal issues (and other areas deemed appropriate), or - more controversially,
- adding appropriately qualified tax advisers to those categories (lawyers) already permitted to undertake certain types of tax-related legal work (as per the US Circular 230 provisions for registered tax preparers, accountants, and the like).

3. Another fundamental policy issue is the perception of fairness and transparency which the US client-attorney privilege creates.<sup>260</sup> Even if the IRS has been a paragon of virtue in all cases, limiting the privilege to matters before the IRS and federal courts and to non-criminal matters - in a context

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<sup>258</sup> McMahan and Shepard, above fn. 215. Kaplan suggests that decisions such as *United States v Frederick* 182 F.3d 496 (7<sup>th</sup> Cir. 1999) have “eviscerated” s 7525: Kaplan, above fn. 226, at 208-09.

<sup>259</sup> Kaplan, above fn. 226, at 208-09.

<sup>260</sup> Taxpayers’ perceptions of the fairness of the tax system one of the variables identified by Jackson and Milliron as having an influence on levels of tax compliance: B.R. Jackson and V. Milliron, “Tax compliance research, findings, problems and prospects”, (1986) *Journal of Accounting Literature*, at 125. See also M. Richardson and A.J. Sawyer, “A taxonomy of the tax compliance literature: Further findings, problems and prospects”, 16 (2001) ATF, Issue 2, at 137.



where there is apparently no doctrine of selective waiver and the IRS controls the determination of whether and when a case will move into the criminal sphere - does little to foster confidence among taxpayers and advisers. A “model” system should extend the tax advice privilege to cover all areas covered by LPP.

4. The US experience (as with that of NZ) again underlines the importance of clear and precise definitions and boundaries *consistent with the policy underpinnings* (noted in (1)). For example, the definition of “tax advice” in s 7525 is less than perfectly clear and is unnecessarily convoluted,<sup>261</sup> and the boundary between tax and business advice uncertain. Similarly, because the definition of “tax shelter” (and its accompanying concepts of “promotion” and “in/direct participation”) is unclear and on a literal view to be almost open-ended, it has become the “exception which swallows the rule”. The meaning and boundaries of key terms need to be clear and precise, to ensure, among other things, that exceptions *do not over-reach their intended aims*.

With the general non-application of the doctrine of “selective waiver”, these uncertainties have hobbled s 7525 from birth.

5. The travails of s 7525 also underline the need for the initiating parliament to keep a weather eye on the ongoing effectiveness of statutory regimes such as s 7525. The s 7525 privilege was introduced in 1998, but appears to have been neglected by Congress since then. The problems (discussed above) in the reach and effective operation of s 7525 have been apparent and discussed in the public sphere for many years. As Kendall observes, “[a]most as soon as IRC s 7525 was inserted into the Internal Revenue Code, commentators began expressing concerns as to the ambiguities relating to its content and scope.”<sup>262</sup>

However, nothing seems to have been done to clarify issues such as the meaning of tax advice, the scope of the tax shelter exception, the legal/business divide, and the various other issues that have emerged over time. A statutory regime cannot be introduced and then left to wither. This is particularly ironic with s 7525, which incorporated the common law and therefore offered the potential for organic growth with LPP.

## 7. CONCLUSION

### 7.1 General observations

As noted at various points in this Paper, there appears to be a groundswell internationally supporting the provision of greater protection for taxpayers in respect of tax advice provided by non-lawyers – i.e. a privilege based on function rather than status. Certainly at a time when a senior UK judge declares

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<sup>261</sup> The ICAA in Australia argued that a “tax advice document” in the ALRC model should include the client’s communication to the agent requesting the advice, together with any other documents giving instructions in respect of that advice; drafts or working papers created in the course of preparing advice (excluding “source” documents); a copy, summary or other record of the advice created by the client or another party where that advice would be privileged if prepared by a lawyer; and a record of oral advice whether prepared by the adviser or client: ICAA, above fn. 113.

<sup>262</sup> Kendall, above fn. 202, at 58; A. Petroni, “Unpacking the Accountant-Client Privilege Under IRC Section 7525” 18 (1999) *Virginia Tax Review* 843 at 847; P.W. Gillet Jr, “The Federal Tax Practitioner-Client Privilege (IRC Section 7525): A Shield to Cloak Confidential Communication or a Dagger for Both the Practitioner and the Client?” 70 (2001) *University of Missouri at Kansas City Law Review*, at 129.

publicly that it is “not easy to see”<sup>263</sup> in the modern context why the logic underpinning the LPP advice privilege should not also apply to accountants, and the functional lines between lawyers and accountants are virtually indistinguishable in the tax practice arena, and given that privilege is a “fundamental human right”<sup>264</sup> which exists to protect the client, it may be time to reconsider the current position.

Certainly the traditional rationales for limiting legal professional privilege to clients who are advised by lawyers are far less convincing in the modern era, but the courts in a range of common law jurisdictions have been reluctant to extend the privilege to non-legal advisers, and non-statutory systems such as the Accountants Concession guidelines in Australia do not seem to offer a satisfactory solution. Further, the tension alluded to in this Paper between lawyers and accountants over the extension of LPP (to accountants) “is a universal phenomenon ... [and its] extension ... will therefore continue to be closely contested in the competitive environment of tax advice.”<sup>265</sup>

Given that statutory protection for tax advisers is very limited in the UK and non-existent in other jurisdictions such as Canada and South Africa, it would accordingly seem an appropriate time to explore expanding privilege to confer a higher level of protection on the clients for the tax advice they receive from non-lawyers.

The issue is not easy – as history attests – because there are significant countervailing policy imperatives in play. On the one hand, as Higgins observes, the current United Kingdom approach<sup>266</sup> (a fortiori those in “unprotected” jurisdictions) “may actually restrict the client’s access to good legal advice. If the client needs advice on tax law, there are very many accountants who are a good deal more legally knowledgeable and qualified to advise in that area than very many solicitors”.<sup>267</sup> On the other hand, Dixon observes that:<sup>268</sup>

“Any expansion of privilege of the sort sought by tax advisers will increase the number of individual cases where the administration of justice would be harmed by denying the tribunal potentially relevant evidence ... The expansion increases the price paid in terms of relevant documents that will not find their way to court, this increasing the risk that cases will be wrongly decided.”

Resolving this policy question is beyond the scope of this Paper, though there does seem to be a discernible trend in Western countries towards exploring the possibility of extending protection to non-lawyers.

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<sup>263</sup> Charles J in *Prudential (HC)*, above fn. Q14, [2009] EWHC 2494 at [69].

<sup>264</sup> *Morgan Grenfell*, above fn. 4, [2002] UKHL 21 at [7].

<sup>265</sup> Keating and Campbell, above fn. 87, at 18.

<sup>266</sup> Higgins, above fn. 11, at 191.

<sup>267</sup> Higgins, above fn. 11, at 191.

<sup>268</sup> Dixon, above fn. 6, at 98 – though Dixon’s attempt to bolster his argument by introducing a “slippery slope” element [“– particularly when we remember that the principle cannot be neatly confined, but would apply whenever any person with a claim to professionalism gives legal advice”] must be discounted. As noted elsewhere in this Paper, there need be no inevitable open-ended “slippery slope” result. The tax discipline is neither pure accounting nor pure law (Keating and Campbell, above fn. 87, at 17) – rather, “[t]he tax professional practice exists in the twilight zone” with tax accountants spending much of their time acting as quasi-lawyers and vice versa: R. Richards, “Tax Accountant or Tax Lawyer” 62 (1992) Issue 2 *Australian Accountant* 23 at 24.

### 7.2 *Issues arising in relation to the introduction of a statutory privilege for tax advice*

Assuming that the policy decision has been made to introduce a statutory privilege of some type, the key threshold question is whether a statutory privilege is to be lesser than, equal to, or wider than common law LPP (and whether “competitive neutrality” is an important policy aim).

The ALRC seemed to favour the NZ system of a separate statutory privilege, and regarded a US s 7525 type-system with some disfavour. The authors would merely observe that while the NZ approach of a separate statutory privilege offers a number of significant benefits (though still retaining some problem areas) – reflecting the fact that its drafters attempted to overcome some of the flaws that had become apparent in relation to the operation of s 7525, the US system should not be discarded lightly. The concept of equating non/lawyer privilege within a constrained area such as tax advice is conceptually attractive and also offers advantages (e.g. by harmonising the development of the statutory privilege and LPP), and the various technical flaws that have brought s 7525 to its knees could be resolved effectively, using the US experience as a diagnostic tool.

The NZ and US experiences indicate that if the creation of unequal access to privilege is a conscious legislative policy choice, this needs to be clearly stated and the level of privilege and circumstances of its application carefully and precisely articulated. If on the other hand it is intended to create a level playing field within the narrow area of tax advice, the US experience suggests that great care needs to be paid to the drafting of the legislation and underpinning materials (and their ongoing “repair and maintenance”) to ensure that this intent becomes reality and continues to be effective in changing circumstances. The apparent reluctance of the New Zealand courts to give the NDR provisions anything but a restrictive interpretation similarly emphasizes the policy clarity required from any Parliament implementing change in this area – especially if the policy intent is to create a statutory privilege *equal to* LPP otherwise the statutory privilege will be read down by the courts compared with LPP.

In either case, the key element is the *net* effect of a statutory privilege - for example, while the *concept* of s 7525 is admirable *en gross*, the plethora of statutory and judge-created exceptions has made it much less effective in practice.

A consideration of the harmonising of different duties and ethical standards (raised by the Australian Treasury)<sup>269</sup> if LPP is extended to tax advisers is also beyond the scope of the Paper. However, arguably the NDR requirement for a “tax advisor” to be a member of an “approved adviser group” – with all the consequent requirements of ethical standards on members – goes some way to addressing these concerns.

### 7.3 *Key points to be addressed in developing any statutory regime*

Experience in various jurisdictions indicates that, if a statutory regime conferring privilege is to be introduced – or, as in the case of the UK, “upgraded” – and whether the regime incorporates a separate statutory privilege or incorporates the common law LPP, several key points must be taken into account. These include:

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<sup>269</sup> Australian Treasury, above fn. 72, at [91].

1. **The ‘threshold issue’.** There needs to be a clear articulation of intended policy aims and their implications, eg what type of regime is it to be; what level of protection is to be afforded (for example, does it extend to tax advice about the effect and application of tax laws in another jurisdiction?); what policy exceptions will apply? Failure to undertake this fundamental task and see it through will doom the regime from the outset, and may result in a conundrum such as that in the structure of s 7525 (“legal” vs “accounting” work) discussed above, which causes unnecessary and debilitating difficulties in the operation of the privilege.

Having made its policy determinations, the Parliament must also be prepared to weather the inevitable storm of criticism from affected sectors that will accompany any change in this area – and the various arguments that will be aired: particularly the “slippery slope” doomsayers. There is no inevitable “slippery slope” that must result in privilege being granted to any one group in society – each extension (if any) would need to be judged on its merits. Given that there is a total<sup>270</sup> (or at least substantial) cross-over between the work performed by accountants and lawyers with respect to tax – a situation that does not arise in other areas where claims for an extension beyond the legal profession are made – floodgates arguments are, in the authors’ views, overstated.

2. **Recognition by Parliament of its ongoing role.** Related to (1) above, the experience of s 7525 highlights the need for Parliament to appreciate that its role will not finish with the introduction of a statutory privilege. There will be an ongoing need to monitor developments and take action quickly to rectify any (major) flaws which emerge from time to time – inevitably given the difficulties inherent in legislative drafting and the impact of changing circumstances. The New Zealand Government is to be congratulated in this respect as it was quick to correct an anomaly in the NDR which meant the statutory privilege did not apply to documents sought by the IRD during the discovery and litigation process.

It might be expected that this will affect a separate statutory regime more than one which incorporates the common law, but the need may arise in any regime.

3. **Ensure there are clear definitions of key terms.** This is easier said than done, but experience demonstrates that it is crucial to have “bright line” definitions and boundaries. Definitions should ideally be clear and self-contained, rather than convoluted or multi-layered. The experiences in NZ with the definition of “tax advice document” or “federally authorised tax practitioner” and “tax shelter” in s 7525 are sufficient to illustrate the difficulties that can develop when key terms are not clear.

Clarity in definition becomes even more important when the courts in the UK, NZ and the US have not necessarily always applied the legislation in ways its drafters might have expected.

4. **Ensure “target accuracy” for the privilege.** “Pattern bombing” is not a useful approach in this context. This means it is important to ensure that the protection of the privilege is first adequate in scope, i.e. it provides the protection needed to the person/s who need it and when they need it. The privilege should not create situations such as those under s 7525 where the privilege cannot be used in criminal tax matters. In addition, it should apply or be able to be asserted at any time rather than (as in NZ) once a formal request for information is made by Inland Revenue - by which time revenue authority officer’s may have already viewed the document. Second, it is vital that the privilege cannot

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<sup>270</sup> Keating and Campbell, above fn. 87, at 16.

easily be “evaded”. For example, the provision should not result in the NZ position where the protection is easily avoided by serving a notice on the taxpayer - who should be the beneficiary of such privileges - rather than the adviser.

5. Linked to (3) is: **Ensure that the (totality of) exceptions do not “swallow” the rule.** Exceptions should be sharply focussed to situations consistent with the policy underpinnings of the policy. They should also be clear and precise – rather than vague (as with the concept of “wrongful act” in the NZ legislation) or potentially open-ended, as with the definition of “tax shelter” in s 7525. For whatever reason, there seems to have been a failure to appreciate the cumulative impact of the totality of the exceptions to s 7525 - though in fairness, part of the outcome rests with the courts, whose pronouncements sometimes seem to veer away from the policy aims of the section.

On the other hand, it is important to ensure that needed exceptions are in place – e.g. it may be that a specific statutory “selective waiver” to protect information disclosed under coercive powers to other bodies such as the SEC could have eased some of the problems with s 7525.

6. **Provide clear guidance for the courts on the objectives and preferred approach to interpretation of the provisions.** The old adage of leading a horse to water comes to mind, but it would no doubt assist courts if the objective of the legislation is made clear (preferably in the empowering Act itself), supported by appropriate interpretation legislation. This is especially important as the courts in NZ and US have construed the respective protection for tax advisers narrowly.

7. **Preserve the integrity and transparency of the regime.** It is important to ensure that the application of the regime is not tainted by *unnecessary* perceptions (accurate or otherwise) that there is the possibility of abuse of the system by regulators. Some of the major criticisms of the s 7525 regime seem to have derived from the fact that the privilege does not apply to criminal tax proceedings, or to matters in state courts, or to communications revealed to other governmental bodies under coercive powers, when the IRS is in a position to control or affect these factors.

While there are a number of difficulties to be overcome in creating any statutory regime – whether stand alone or incorporating elements of the common law – to extend privilege to tax advisers, insights drawn from the experiences in the UK, NZ, US and Australia provide a very useful “manual” for those facing such a task.