Client Alert

pillsbury

Federal Tax Controversy & Tax Policy
Corporate & Business Transactions
Tax
International Tax

October 28, 2010

No Extension of English Law Privilege to Accountants, Non-Lawyer Tax Advisers

by Anne Fairpo and Raymond L. Sweigart

The UK Supreme Court decision in Prudential PLC and Prudential (Gibraltar) Limited v Special Commissioner of Income Tax and Philip Pandolfo (HM Inspector of Taxes) *has confirmed that legal professional privilege only covers communications with lawyers and does not include communications with accountants and other non-lawyer tax advisers. Communications with non-lawyer tax advisers must be disclosed to HM Revenue & Customs if requested by notice under Schedule 36 of Finance Act 2008 (formerly s20 TMA 1970).*

What is the legal professional privilege ("LPP") under English law?

LPP is a set of common law rules protecting communications between a professional legal adviser (a solicitor, barrister or attorney) and his or her clients from being disclosed without the permission of the client. It is often broken down for discussion into legal advice privilege and litigation privilege.

The LPP rules of evidence allow a party to litigation to withhold disclosure of certain categories of documents which are relevant to dispute—note that it relates to categories of documents, not individual specific documents as such. LPP has not been defined in legislation—it is a common law concept that has developed in case law over time, and continues to develop.

Parties to litigation are obliged to disclose all documents that they are relying on, and all those that are damaging to their case. LPP exists to ensure that clients can fully disclose information to their lawyers without needing to be concerned that the information will be used against them in subsequent litigation. For example, LPP allows a realistic discussion of areas of potential weakness and counter-arguments in the client's position.

LPP belongs to the client and not the lawyer—only the client can waive privilege. Care needs to be taken with waivers, as disclosure of one privileged document may result in a waiver over that class of documents (the courts are not inclined to encourage parties to pick and choose which documents to disclose). LPP can also be easily lost—for example, if a client forwards to his accountant an email containing legal advice

from his lawyer, that email is no longer protected by privilege from disclosure. If the email is forwarded in confidence, privilege may still be claimed, however, as it may still retain its confidential character.

Litigation privilege

Litigation privilege is distinct from legal advice privilege. Litigation privilege covers a wider range of documents and can cover communications with non-lawyer third parties (including accountants)—but it **only** applies where litigation has already commenced, or where there is a real likelihood of litigation when the communication is made.

For litigation privilege to exist, the main purpose for a communication or a document must be to obtain legal advice, evidence or information in preparation for such litigation. Litigation privilege does not apply to communications with accountants or other third parties in respect of non-contentious tax legal advice on transactions, or tax planning, even if the tax treatment is sufficiently aggressive that a challenge to that tax treatment from HM Revenue & Customs should be expected.

Legal advice privilege

Legal advice privilege protects confidential communications between a client and professional legal adviser. The purpose of the communication must be to seek legal advice—*e.g.*, sending a contract to a lawyer for comment does not make the contract itself privileged although the letter sending it, and the lawyer's response, will be capable of being privileged documents.

The *Three Rivers* case contains some helpful definitions of legal advice privilege set out by the House of Lords. In particular, it confirmed that LPP protects "advice as to what should prudently and sensibly be done in a relevant legal context" as well as advice on legal rights and obligations. The court noted that, in effect, the lawyer should have donned "legal spectacles" if the communication is to be privileged.

Who is a professional legal adviser?

LPP applies to communications with professional legal advisers, who are:

- Solicitors
- Barristers
- Licensed conveyancers
- Patent and trade market agents
- Legal executives (recognised by ILEX)

Who is the client?

The *Three Rivers* case considered who would be the "client"—the person with legal advice privilege—and decided that in the corporate context only the people expressly or impliedly tasked with obtaining or receiving legal advice can be the client. One cannot assume that all employees within a client organisation will be "the client".

It is therefore important for the legal adviser and those instructing him or her to determine who constitutes "the client" at the beginning of a matter, and those designated need to be careful that privileged communications do not lose privilege by being copied to others in the same organisation who are not within the definition of the client.

Tax and LPP—limits on legal advice privilege

s20 TMA 1970, now Schedule 36 of Finance Act 2008, gives HM Revenue & Customs powers to require a taxpayer or third party to disclose documents which contain (or they reasonably believe might contain) information which is relevant to the taxpayer's tax liability. The *Morgan Grenfell* case in 2002 confirmed that s20/Schedule 36 does not apply to documents covered by legal advice privilege, so these can be withheld.

Communications with accountants are not covered by legal advice privilege, and so will need to be disclosed if requested in a s20/Schedule 36 notice even if they relate to legal advice - this has been confirmed in the recent *Prudential* case. Prudential had argued that, where skilled professional advice on tax law is given by accountants, the rules of legal advice privilege should be applied to that advice. In particular, they argued that it was the nature of the advice that was important, not the status of the adviser.

The Supreme Court considered that, as the provisions relating to LPP in tax matters have been recently updated, after consideration and consultation with relevant professional bodies, it is no accident that legal advice privilege has not been extended to accountants giving advice on tax law.

In particular, since legal advice privilege is an absolute rule and allows a party to litigation to withhold documents, the Supreme Court held that the rule must be clear and certain in its application. Extending privilege to other professions who give advice on points of law would raise serious questions as to its scope—in particular, to which accountants and other professional advisers would it apply? There is no statutory definition of an accountant. Finally, the Court of Appeal considered that such an extension to privilege could only be done by Parliament introducing primary legislation, and the Supreme Court did not disagree.

Accordingly, taxpayers who obtain tax advice from accountants and other non-lawyers continue to have less protection than those receiving tax advice from lawyers, with the result that the advice is vulnerable to disclosure in the event of litigation with HM Revenue & Customs or other parties.

In-house lawyers and European cases

There are specific problems for in-house lawyers—they may be both legal and business adviser, and may be both lawyer and client.

The *Akzo Nobel* case in the European Court of Justice has confirmed, however, that the advice of in-house lawyers is not covered by LPP in EU law, so that documents prepared by an in-house lawyer cannot be withheld on the grounds of LPP even if the document is confidential and contains legal advice. This follows a line of cases which established the principle in EU law that LPP only applies to communications with "independent" lawyers—the in-house lawyer's employment relationship with their client means that they are not considered sufficiently independent. In addition, the independent lawyer must usually be a member of a recognised bar or law society of an EU member state, and there is some suggestion that communications with non-EU lawyers may likewise not be recognised as privileged.

This is a European law decision, and does not affect English law directly, so that in-house lawyers are still considered to have the benefit of legal advice privilege where advice is given in their capacity as a legal adviser, although care needs to be taken to ensure that the advice being given is related back to the relevant legal context and is not business advice.

The *Akzo* case relates only to proceedings at the EU level, and concerned competition law which is directly governed by EU law. However, an increasing number of tax cases are being referred to the ECJ for decisions and it should be noted that the LPP which exists for in-house lawyers at the national level may not apply if the case is so referred and previously privileged documents may need to be disclosed and privilege lost accordingly.

Accordingly, if there is any prospect that the case may be referred to the ECJ in future (and this is a process that can take years) then in-house lawyers should consider instructing external lawyers from the outset, to ensure that privilege can be maintained throughout the process.

Key points to remember

I. Involve lawyers as soon as it becomes apparent that legal advice on tax matters is likely to be required, to ensure that privilege arises before potentially damaging communications are created, and internal procedures should be put in place to minimise the creation of unnecessary non-privileged documents.

II. If tax litigation is not involved, privilege only attaches to confidential communications between the client and lawyers. Hence it is important that tax law advice on planning and transactions should be sought from lawyers, not from accountants.

III. Identify the client within the instructing organisation - the group of employees who are specifically to request and receive legal advice; note that too wide a definition could be rejected by the courts as artificial, so a client team that is “everyone” within a company or department should be regarded as inappropriate (unless it is a very small company or a specialist department). The client team can change as appropriate, but any such changes should be recorded and kept under review.

IV. “Non-client team” employees should not create documents for the lawyers and people on the client team, as these documents are unlikely to be covered by privilege.

V. Keep documentation to the minimum necessary, to reduce the risk of loss of privilege - do not, for example, ask non-client team employees to keep a record of a conversation. Telephone calls are a better mechanism for discussing matters than email - this is often overlooked, remember that emails are documentation in the same way as letters.

VI. Limit circulation of legal advice: if this is sent to people outside the client team, including the organisation’s accountants, it will lose confidentiality and possibly lose privilege. If it is necessary to send documents outside the client team, consult the lawyers first and always ensure that the document includes an express instruction to keep the document confidential. Consider whether a meeting to discuss the contents would be more appropriate than passing on the document itself.

VII. Be particularly careful with copying legal advice to someone in another legal jurisdiction - the same privilege may not apply in that jurisdiction. Don’t forget Scotland is a separate legal jurisdiction to England and Wales.

VIII. For LPP to exist, the lawyer must be giving advice in his professional capacity and must be a member of a relevant legal profession (cf: Howes v Hinckley & Bosworth Borough Council): communications with a solicitor working for an accountancy firm as a tax advisor, for example, will not be covered by LPP.

For more details of the *Akzo Nobel* case, see also our Litigation Advisory of May 17, 2010 and our Litigation Alert of September 24, 2010.

For further information, please contact:

Anne Fairpo (bio)
London
+44.20.7847.9611
anne.fairpo@pillsburylaw.com

Raymond L. Sweigart (bio)
London
+44.20.7847.9607
raymond.sweigart@pillsburylaw.com