

# Bridging the Atlantic Series

February 2014



## Privilege – is the tax advice you receive protected?

If you are looking for tax advice in the UK, make sure that it will be legally privileged.

In the UK, legal professional privilege provides important - often critical - protection against having to disclose certain information or communications to third parties, including the tax authorities and the courts. In general terms, to obtain the protection of privilege, the information must be confidential and not have been disclosed to a third party. If a taxpayer successfully claims privilege they are entitled, as an absolute right, to withhold the protected information.

There are two types of legal professional privilege: legal advice privilege and litigation privilege. The circumstances in which each can be claimed differ.

### Legal advice privilege

Legal advice privilege is the most commonly claimed head of privilege. Its purpose is to enable a client to place unrestricted confidence in his lawyer. However its ambit is narrow. In particular, it applies only to communications passed between a taxpayer and their lawyer, where certain conditions are satisfied. Advice from accountants and other advisors is not, under any circumstances, protected by legal advice privilege. This was recently confirmed by the Supreme Court.<sup>1</sup>

A document will attract legal advice privilege if:

- (a) it is a confidential communication;
- (b) between a client and his lawyer; and
- (c) the purpose of the communication is to seek or obtain legal advice.

### Confidential communication

There can be no privilege without confidentiality. If, therefore, a privileged document has lost its confidentiality there can be no claim for privilege.

Documents originating from both the client and the lawyer are privileged, so long as they are kept confidential and were created for the purpose of seeking legal advice.

It appears that there are no requirements that documents prepared by a lawyer during the course of his retainer must be communicated to the client. It was accepted by the Court of Appeal in *Three Rivers (No 5)*<sup>2</sup> that a lawyer's own drafts of documents and memoranda were privileged even if not transmitted to the client.

By contrast, memoranda prepared by the client as a preparatory step to obtaining legal advice may not be privileged if there was never any intention of communicating them to the lawyer. However, for reasons of public policy, such drafts would be privileged as the consequence of requiring disclosure would be effectively to remove privilege between lawyers and clients via the back door.

### Communication between a lawyer and a client

The definition of "client" is narrow; in the corporate context, the "client" is regarded as only those employees or officers who have been specifically designated to seek legal advice on behalf of the company, or have a demonstrable "need to know" the advice.

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Berwin Leighton Paisner

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<sup>1</sup> *R (on the application of Prudential PLC & Anor) v Special Commissioner of Income Tax & Another* [2013] UKSC1  
<sup>2</sup> *Three Rivers District Council & Ors v The Bank of England* [2003] EWCA Civ 474.

This will normally only include a relatively small, "core" group of employees or officers and will not include the vast majority of a company's employees, even if those employees might otherwise play a role in assembling information or creating documents for the purpose of seeking legal advice. According to *Three Rivers (No 5)*, legal advice privilege will not cover internal generic documents generated by employees of the client even if they are necessary to provide information to lawyers to obtain legal advice.

The term "lawyer" includes solicitors, barristers, foreign lawyers and salaried, in-house lawyers. It does not extend to accountants.

### What is legal advice?

The courts have concluded:

*"... legal advice is not confined to telling the client the law; it must include advice as to what should prudently and sensibly be done in the relevant legal context".*

Legal advice is not limited to advice on the client's rights and liabilities. However, pure business advice such as advice on investment or finance policy given by a lawyer will not be privileged.

### "Privileged and Confidential"

Disclosure of advice from the recipient of the advice within an organisation to others within that organisation should be made subject to appropriate confidentiality obligations.

Communication of privileged advice from the recipient within the company to a company's board of directors should not cause loss of privilege (either in the original document or in the subsequent communication), nor should oral submissions of advice at a board meeting. Best practice is for files to be kept up to date and correctly labelled (i.e. "privileged and confidential" or "prepared for the purposes of litigation") to avoid inadvertent waiver of privilege.

### Litigation privilege

Litigation privilege arises where:

- (a) litigation is either existing or anticipated;
- (b) the document in question is confidential; and

the document in question is produced for the dominant purpose of seeking or obtaining legal advice, evidence or information in connection with such existing or anticipated litigation.

### Litigation is existing or anticipated

Whether or not litigation is "anticipated" is a question of fact. Anticipated litigation is that which is in "reasonable prospect", and may exist even before a cause of action arises. Litigation must be a real likelihood rather than a mere possibility, although the chance of litigation need not be greater than 50 per cent<sup>3</sup>.

A distinct possibility that sooner or later someone might make a claim or a general apprehension of future litigation is enough.

### Dominant purpose test

The "purpose" test is one of dominance and not exclusivity. The court will look at the purpose of the document objectively. In *National Westminster Bank*<sup>4</sup>, the court was prepared to accept witness evidence that the defendant's internal investigation report was prepared for the dominant purpose of litigation, despite the fact that contemporaneous documents suggested otherwise.

### Communication with third parties

The key distinction between legal advice privilege and litigation privilege is that the latter extends beyond the lawyer/client relationship, to cover communications between a lawyer and third parties. Third parties, who have an interest in the pending/contemplated litigation, could claim litigation privilege. Such parties could include company employees who are not the "client", accountants, experts and/or witnesses.

### The UK tax authority's approach towards privilege

In the current UK tax environment, the UK tax authority HM Revenue & Customs ("HMRC") is becoming ever more inquisitive and is increasingly challenging taxpayer's claims to withhold privileged documents from disclosure during a tax enquiry or dispute.

Since 2009, where there is a dispute between a taxpayer and HMRC which concerns whether a document is protected from disclosure by legal professional privilege, a procedure exists to refer to the court of first instance (the "Tribunal") for determination under the "Information Notice: Resolution of Disputes as to Privileged Communications Regulations" SI 2009/1916 (the "LPP Regulations").

In recent times HMRC has made frequent use of this procedure, and is not hesitating to challenge assertions of privilege by the taxpayer.

<sup>3</sup> *USA v Philip Morris Inc and British American Tobacco (Investments) Ltd* [2004] All ER (d) 448 (Mar)

<sup>4</sup> *National Westminster Bank Plc v Rabobank Nederland* [2006] EWHC 218 (Comm)

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## The Tribunal approach

The Tribunal will carefully examine each document challenged and scrutinise its contents to determine whether privilege attaches, as highlighted by two recent decisions concerning applications made under the LPP Regulations.

In *Edward C Behague*<sup>5</sup>, HMRC challenged the privileged status of the following: an engagement letter between the taxpayer and his solicitors, and a legal report prepared by the solicitors and the schedules attached thereto.

Judge Mosedale found that although an engagement letter is not by nature subject to legal professional privilege, if parts of it set out what the legal advice sought will cover, these parts would be subject to legal professional privilege.

As regards the report itself, the Tribunal dismissed HMRC's argument that it comprised financial or wealth management advice and not legal advice. It held that the report was legal advice and therefore subject to legal professional privilege.

In relation to the schedules attached to the report, the Tribunal held that the schedules would not be subject to legal professional privilege were they stand-alone documents. However, as their disclosure would enable a person to identify the subject matter of the legal advice contained in the report, Judge Mosedale concluded that they were covered by legal professional privilege. The privileged nature of the report extended to cover its schedule.

In *Lewis v the Commissioners for HM Revenue & Customs*<sup>6</sup>, the issue concerned whether certain documents were subject to litigation privilege. As part of an enquiry into the tax treatment of a payment received by Mr Lewis on the termination of his employment, HMRC issued a notice under Schedule 36 Finance Act 2008 requiring Mr Lewis to produce, inter alia, certain correspondence between his solicitor and his former employer relating to the termination of his employment.

The taxpayer sought to withhold this correspondence on the basis that it was protected by litigation privilege. Judge Sinfield dismissed the taxpayer's arguments and held that litigation privilege was not available. Although the correspondence was privileged as regards any proceedings between the taxpayer and his employer in relation to the termination, it was not produced or created in contemplation of litigation with HMRC. Accordingly, litigation privilege would not extend to prevent disclosure of the correspondence in the entirely unrelated proceedings with HMRC.

## Practical tips

It is now more important than ever for taxpayers to consider the rules of privilege from the outset in order to avoid sensitive documents from being disclosed to HMRC.

Taxpayers would be well-advised to protect their position by the following:

- Taxpayers seeking tax advice outside of the litigation context should take steps that this advice is obtained from lawyers and not accountants in order to ensure that legal advice privilege applies.
- Ensure that legal advice is not circulated widely or indiscriminately, causing confidentiality to be lost. If confidentiality is lost, privilege is lost.
- Files should be kept up to date and correctly labelled (i.e. "privileged and confidential" or "prepared for the purposes of litigation") to avoid inadvertent waiver of privilege.
- Take care that any redaction of privileged material is consistent across all relevant documents. Inconsistent redaction can result in HMRC raising queries or even waiving privilege.
- Keep contemporaneous notes recording the purpose of any communication at the time of its creation. This is useful evidence if a dispute over privilege later arises.

<sup>5</sup> TC02983

<sup>6</sup> TC/2013/05924

## Getting in touch

If you would like to talk through your project or discuss solutions to your legal needs, please get in touch.

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