

Tax briefing



Prudential decision and tax structuring

A cautionary tale

The Supreme Court's judgment in *R (Prudential plc and another) v Special Commissioner of Income Tax and another* confirmed that legal advice privilege (LAP) only extends to legal advice given by qualified legal professionals and not to legal advice given by other professional advisers ([2013] UKSC 1) (see News brief "Legal advice privilege: only lawyers can join the club", www.practicallaw.com/0-523-7993). The decision has particular relevance for tax structuring advice, which is mainly given by non-legal professionals and so may not be protected from disclosure, especially when demanded by HM Revenue & Customs (HMRC) under its statutory investigative powers.

The dispute

The main issue in *Prudential* was whether LAP should attach to communications passing between accountants and their clients, in circumstances where LAP would attach to those communications had the same advice been given to the same client by a qualified lawyer (see box "Legal professional privilege").

The dispute arose after HMRC demanded that Prudential provide documents in connection with a tax avoidance scheme which had been devised by its accountants. Prudential withheld certain documents and claimed LAP in respect of them. After receiving statutory notices from HMRC requiring delivery of the documents, Prudential brought proceedings for judicial review, claiming that the notices were invalid as the documents were covered by LAP and, therefore, HMRC could not lawfully require their disclosure.

Legal professional privilege

There are two types of legal professional privilege: legal advice privilege (LAP) and litigation privilege. LAP applies to any communication between a client and its professional legal advisers that relates to the rights, liabilities, obligations or remedies of the client under private or public law (*Three Rivers District Council v Governor and Company of the Bank of England (No 6)* [2005] 1 AC 610; www.practicallaw.com/4-103-2418). Litigation privilege attaches to communications which come into existence with the dominant purpose of being used in aid of pending or contemplated litigation. (For more information, see feature article "Privilege: what can you protect?", www.practicallaw.com/0-102-3897.)

The High Court rejected Prudential's application on the basis that LAP does not extend to advice provided by a professional person who is not a qualified lawyer. The Court of Appeal and the Supreme Court both dismissed Prudential's appeals.

Supreme Court decision

Lord Neuberger, giving the lead judgment in the Supreme Court, stated three primary reasons for dismissing the appeal:

- Allowing the appeal would be likely to lead to what is currently a clear and well understood principle becoming unclear and uncertain.
- Extending LAP to cases where legal advice is given by professional people who are not qualified lawyers would raise questions of policy, which should be left to Parliament.
- Parliament has enacted legislation relating to LAP, which, at the very least, suggests that it would be in-

appropriate for the court to extend the law as proposed by Prudential.

The decision is notable as the majority acknowledged the strength of the case for allowing the appeal. However, while Lord Neuberger admitted that the restriction of LAP to advice from members of the legal profession was "illogical in the modern world", it was explicable by reference to history and, even if a common law rule appears to be outmoded, it is not always right for the courts to intervene.

Tax structuring

Although *Prudential* affects the ability to assert LAP in all circumstances, including, for example, to resist disclosure in civil litigation, its main relevance to tax structuring, and the motivation for Prudential and its tax advisers to pursue the case, arises from HMRC's statutory powers of investigation.

HMRC has broad powers contained in section 113 of, and Schedule 36 to, the Finance Act 2008 (FA 2008) to obtain

information or documents, if reasonably required for the purpose of checking a taxpayer's tax position, from either the taxpayer or a third party, by issuing an information notice. These powers broadly replace similar powers contained in the Taxes Management Act 1970 and which were the subject of *Prudential*.

An information notice does not require a person to produce privileged information or any part of a document that is privileged, so the incentive for taxpayers and their accountants to expand the scope of LAP to cover their relationship is clear (*paragraph 23, Schedule 36, FA 2008*). As the majority of tax structuring is not carried out by legal professionals, the restriction of privilege to legal professionals is particularly significant, and might even be said to be outmoded.

That said, tax advisers and statutory auditors are granted separate protection from HMRC's investigative powers. Auditors are generally not required to provide information held in connection with their statutory function (*paragraph 24, Schedule 36, FA 2008*). Tax advisers are generally not required to provide communications with a client (or any other tax adviser of the client), or information about communications, the purpose of which is giving or obtaining advice about the client's tax affairs (*paragraph 25, Schedule 36, FA 2008*). However, these exemptions are only relevant to third-party information notices, and not to information notices served on the taxpayer directly (as occurred in *Prudential*), so auditory or tax advice is potentially disclosable in any event.

Practical considerations

Prudential is a confirmation of the accepted position and does not create any new concerns for taxpayers and their advisers. However, it is a useful reminder that one should carefully consider the confidentiality of tax advice. The application of LAP does not depend on the content of advice but on the identity of the person who gave it. Taxpayers should be wary that any

advice provided by a non-legal professional, even where such advice constitutes legal advice, may be demanded by HMRC under their statutory investigative powers.

Although the provision of advice (or related documents) should not directly give rise to a tax charge, HMRC will look to it to help ascertain intention and motivation where relevant. This will be particularly relevant in the context of anti-avoidance legislation, which is typically triggered where a purpose, or one of the main purposes, of a transaction or arrangement is to secure a tax advantage. This relevance will only increase with the introduction of the general anti-abuse rule (GAAR) in 2013 (www.practical-law.com/6-523-7909).

It should also be noted that non-privileged documents may be disclosed during the course of litigation. Taxpayers should consider the potentially adverse implications of tax documents entering the public sphere including, for example, reputational risk.

It is also important to consider the source of any legal advice that is purported to be given by a qualified lawyer but that originated from another person, to determine whether it is covered by privilege. For example, where a memorandum of advice has been prepared by accountants but is forwarded, without modification, to a client by the solicitors advising on the transaction, it is questionable whether this will constitute legal advice given by a qualified legal professional for LAP purposes.

The situation is likely to become more complicated with the advent of alternative business structures (ABSs) for the provision of legal services, made possible by the Legal Services Act 2007 (2007 Act) (see *Exclusively online article "Alternative business structures: the market begins to take off"*, www.practical-law.com/7-518-2435). Broadly, a firm will constitute an ABS if a non-lawyer is a manager of, or has an ownership-type interest in, the firm. A firm may also be an ABS where another body is a

manager of, or has an ownership-type interest in, the firm, and (in either case) at least 10% of that body is controlled by non-lawyers.

ABSs will need to be particularly sensitive to their clients' concerns regarding privilege and confidentiality where multiple advisers from different professions are working on a matter. It may be necessary, for example, for ABSs to implement safeguards to ensure that any advice which may reasonably benefit from LAP is always provided by a qualified lawyer or an adviser who is acting at the direction, and under the supervision, of a qualified lawyer (*section 190, 2007 Act*).

A plea to Parliament?

Viewed as a whole, *Prudential* may be characterised as a plea to Parliament. The majority left no doubt that they considered there to be a strong case for expanding the category of professional advisers covered by LAP, but it was considered a job for Parliament rather than the courts. The minority also acknowledged that, even if the appeal were to be allowed, Parliament may need to legislate; Lord Clarke expressed a hope that Parliament would consider the issue as soon as reasonably practicable.

If Parliament does take up the call for reform of LAP, it will be interesting to see whether an expansion of the application of the doctrine will conversely lead to a restriction of its effect as Parliament takes the opportunity to exert greater control over what has always been a common law principle. It also remains to be seen whether, at a time when the public mood is captured by the media scrutiny currently aimed at the tax affairs of corporates and wealthy individuals, Parliament has the appetite to legislate further ways in which to keep such affairs hidden from view.

Jonathan Kandel is a tax partner, Oliver Walker is a senior expert in the tax litigation and corporate tax practice, and Tim Goldfarb is an associate in the litigation practice, at Weil, Gotshal & Manges LLP.