INFORMATION: COMPLIANCE v CONFIDENTIALITY

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In this presentation, I consider the relationship between compliance and confidentiality in the context of the UK tax system. The question essentially is – how does legal privilege square up against Revenue investigation powers? Although I look at the topic from a specifically English law perspective, I am sure that what I say will have resonances with experts from other jurisdictions, as the subject of compliance and confidentiality is, of course, of general world-wide significance and topicality.

The three main heads of privilege recognised by the law of England and Wales are, first, the privilege against self-incrimination, second, the privilege for *without prejudice* correspondence. Neither of these has much relevance to my topic. The last head of privilege is what is generally called "legal professional privilege", although this name may confuse, because it is not the privilege of the lawyer but of the client; this is the head of privilege with which we are especially concerned when we consider the power of the Inland Revenue to obtain documents pursuant to s.20 of the Taxes Management Act, 1970. The section itself is part of an elaborate series of provisions to be found in eight sections of the Taxes Management Act which are generally referred to together as "section 20". These eight sections deal with power to compel the production to the Inland Revenue of documents and the furnishing

of particulars (that is the giving of evidence) by taxpayers and others – in particular, by third parties often referred to as "innocent third parties", such as banks and professionals. The documents and particulars in question must be "such as in the reasonable opinion of the Inspector of Taxes issuing the notice" under section 20 or, in some cases, in that of the Commissioners of Inland Revenue themselves, "contain or may contain or are information relevant to a tax liability to which the taxpayer may be subject" (the taxpayer being the person under investigation). These provisions constitute a detailed code regulating to whom, by whom and subject to what threshold requirements, both procedural and substantive, such notices may be given. They are a labyrinth of detailed regulations which govern more or less every aspect of the exercise of this investigatory power. The powers include a power to raid, contained in the section which is called s.20C. This power is usually exercised at 7 o'clock in the morning. The power to raid under s.20C is arguably the most intrusive power: it is a power to enter and search specified premises, if necessary by force, where there is reasonable ground to suspect serious fraud, and evidence of it is likely to be found on the premises. The least intrusive power is, perhaps, the power under subsection (1) of s.20 – the power to call on a taxpayer himself to deliver documents.

What documents attract privilege? There is a distinction between cases where litigation is contemplated and those where it is not, and in the context of section 20, and in most investigation powers,

we are most likely to be concerned with the head of privilege which applies where litigation is not contemplated. Where litigation is not contemplated, only communications passing between a client and his lawyer and vice versa are protected, and then only when the lawyer is acting as such and is advising or taking instructions from his client. This is advice privilege. The lawyer does not have to be an English lawyer. One of the recent cases in the United Kingdom is the case of *ex parte Tamosious* [1999] STC 1077. Alwyn Tamosious is a US lawyer practising in the United Kingdom, and there was never any doubt that the documents in his possession were documents held by a lawyer and *prima facie* the subject of legal professional privilege, notwithstanding the fact that he was not a barrister, advocate or solicitor. The privilege extends to communications between the lawyer or his agent acting as such and the client or his agent, but for this privilege to attach to documents the relationship of client and lawyer must have been established or at least have been contemplated when the communication in question came into existence, and it must be referable to that relationship. In general, communications to be privileged must be for the purpose of, or related to, the giving or obtaining of legal advice. The privilege attaches to communications within an organisation where one party is the employed lawyer of another, or of the organisation as such. The privilege does not attach, in the absence of contemplated litigation, to documents provided by third parties to a lawyer to enable him to give an opinion. Those documents have not come into existence for the purpose of the advice, and so they are not generally

privileged unless there is contemplated litigation. But, on the other hand, advice privilege does attach to correspondence from a lawyer to his client where he reports, in giving advice, a conversation that he has had with third parties, and it attaches to documents sifted and selected by the solicitor in the exercise of his own judgment, because that is all part and parcel of what has been called the continuum of the giving and receiving or obtaining of legal advice. Litigation privilege – as it is sometimes called – is rather wider than advice privilege. Where litigation is contemplated, documents created by third parties are privileged so long as the dominant purpose of their being brought into existence was possible or existing litigation. It does not have to be the sole purpose, but it must be the dominant purpose.

There are five other points to make about the scope of privilege. First, it appears to protect an entire document even if part is and part is not privileged. Secondly, it does not protect communications intended to facilitate crime or fraud. This is an important exception and the Inland Revenue rely on it wherever they can, when they are investigating suspected tax fraud. So when you make a claim for privilege, the first thing they will say is, "We have to be satisfied that the document wasn't intended to facilitate crime or fraud." Thirdly, privilege can be lost, either by waiver or by the document coming into the hand of a third party, no matter how the document gets into a third party's hand – whether by accident or fraud or however, and that is the reason for the familiar rubric on all lawyers' fax sheets, that *this information may be privileged and if it has got*

to the wrong place it must be returned without being looked at. Fourthly, privilege is that of the client; the lawyer has a duty to claim it, unless instructed not to do so, but it is his client's privilege and not his. A lawyer's duty to his client to claim privilege may conflict with his *prima facie* obligation under section 20 to give disclosure to the Inland Revenue. When a section 20 notice is served on a third party with legal professional obligations of confidentiality to his client, the recipient is caught in a nutcracker between his obligation to give disclosure to the Inland Revenue in accordance with the requirements of section 20, and his obligation not to give disclosure because it is his client's privilege, which he cannot waive unless instructed to do so – and generally he will only be instructed to do so if he has first advised the client to give the instructions.

Lawyers in that situation are in a difficulty and that is the difficulty in which clients of mine found themselves in the firm of Davies Frankel & Mead. They were served with a widely-drawn notice under s.20(3) to produce most – but not all – of the documents they held relating to a particular client whom the Inland Revenue were investigating. In order to deal with that, they brought judicial review proceedings, which were heard by Mr. Justice Moses in June of last year, in order to try to get a resolution of the problem with which they were faced. The judicial review failed, but permission to appeal to the Court of Appeal was obtained and that brought sufficient pressure on the Inland Revenue to effect a settlement.

The last point to make about the scope of privilege is that under the general law it is given only to communications with lawyers, though by statute it has been extended to certain others such as licensed conveyancers and trademark and patent agents. But it does not extend to someone acting as a legal adviser who is not actually a lawyer. That means it does not protect communications with an accountant, even though the accountant holds the papers subject to an implied duty of confidentiality.

Let me now consider the nature of the rule, and ask whether it is procedural or substantive. It is only if it is a substantive rule, rather than a procedural rule, that it can be of help in resisting the exercise of the Inland Revenue's investigation powers. We all tend to believe that privilege is such a fundamental right that its existence must go back into pre-history, but this is not true. Until comparatively recently, it was regarded as a purely procedural rule relating only to the production of evidence in the proceedings of a judicial or quasi-judicial nature. In proceedings, the other side was prohibited from seeing the instructions that the client had given to his lawyer, and this prohibition was regarded as a procedural rule. This was certainly the view of Lord Justice Diplock as recently as 1969, in the case of *Parry-Jones v. the Law Society* [1969] 1 Ch. 1.

That was a decision that the Law Society – not being party to any litigation – could look at solicitors' clients' privileged documents for certain regulatory purposes. On this view of privilege, it could never be a

defence to any exercise of any statutory power, and the fact that privilege started as a rule of evidence in judicial proceedings is the source of the practical difficulty that there is no obvious solution to the problem of finding ways to resolve disputes as to whether privilege applies to any particular document in the context of an Inland Revenue investigation. This is a problem, I imagine, in other jurisdictions; it was first addressed in the United Kingdom in the context of direct tax, in the *Tamosious* case in 1999. Latterly, it has received legislative attention in the amendments to section 20 introduced by the Finance Act 2000.

In the 1970's and 1980's a movement began in the Commonwealth which decided, in effect, that privilege was a fundamental rule giving substantive rights, and not just a procedural protection in the context of litigation. In England – as well as the rest of the Commonwealth – privilege is now recognised as a substantive rule of law and not merely a procedural one. It is indeed a fundamental right. It was described in 1994 as both an important auxiliary principle serving to buttress the cardinal principles of unimpeded access to the Court and to legal advice, and also a fundamental common law right, which will only be abolished by the words of a statute if that is required by necessary implication from the statutory language.

However, that abolition is required by necessary implication to be derived from statutory wording in section 20: this was precisely what the Court of Appeal held in the *Morgan Grenfell* case [2001] STC 497. It

held that the terms of section 20 generally abolish legal professional privilege in the context of the exercise of tax investigation powers, and that is why the case is such a controversial one. Where there is no abolition of it by express words or necessary implication, privilege can, of course, be a defence to the exercise of a statutory power of investigation.

How does privilege apply to statutory powers of investigation? The simple answer to this question is that privilege applies when the statute permits it to apply. In the context of section 20, it is only expressly available where lawyers are involved – where the notice requiring disclosure is served on a lawyer, or where, in the context of a raid, it is a lawyer's premises that are being raided: there is specific reference in the statute to lawyers in these two contexts. However, there was an amendment in the Finance Act 2000, which amended section 20 and introduced a new procedure, giving a wider privilege defence against a notice to produce documents. Where a notice under this new procedure is issued, the privilege does not just apply to lawyers. In the old section 20 it specifically did just apply to lawyers, and that is why the Court of Appeal said, quite simply, that if the statute says that privilege applies to lawyers only (and the Court was looking at the pre-2000 legislation in that case), then, by necessary implication, it does not apply to anybody else. In the *Morgan Grenfell* case, what the Inland Revenue were asking was for documents containing legal advice which were not, in fact, held by lawyers. So the Court of Appeal said, "In those circumstances, although the right to privilege is indeed a

fundamental common law right, you can't refuse to produce this legal opinion because the document in question wasn't held by a lawyer". And there is a necessary implication that because the statute says the defence only applies where the document is held by a lawyer, it does not apply where the document is not held by a lawyer. With that decision we have reached the position that legal professional privilege is *prima facie* a defence to the exercise of a statutory power of investigation, unless the terms of the power demonstrate expressly or by necessary implication that it is not to be, and that by conferring expressly on a limited class of persons (in this case, lawyers) the defence of privilege to an exercise of a statutory power, Parliament has demonstrated that it does not intend anyone outside that class to have the benefit of the defence. It is a decision that the fundamental right to legal privilege should yield to the other right in play – the public interest in the prompt, fair and complete collection of the public revenue. But it does, nonetheless, seem distasteful that a man should generally be compelled to produce his legal advice. Is this in accordance with sound policy? Also, it is an odd reflection that if the section 20 code had been silent about privilege altogether, instead of giving it expressly where the documents were held by lawyers, then the Court of Appeal's reasoning in the *Morgan Grenfell* case, based on what it called the "principle of legality" that is the fundamental nature of the right to privilege, would have led it to the conclusion that privilege was a defence against any exercise of the investigatory power. So you get the ironical – and almost paradoxical – situation that because Parliament has

expressly mentioned privilege as a defence for lawyers, it has diluted the efficacy of the right – confining it to the situation that is expressly mentioned, rather than leaving it to apply generally, which would have been the case if it had not been mentioned at all!

Our rule about privilege stems from the conflict, in an adversarial system, of two principles of law. The first is that the tribunal or the court seized of the matter must have the whole truth, and the second is that the client should be able to get untarnished advice, and, in order to do that, he must be able to tell his lawyer the whole truth, without fear that the lawyer will ever say what he has been told. The balancing act between these two principles was done long ago, and it was decided, as Lord Taylor said in *R v. Derby Magistrates Court e ex p. B.* [1996] AC 487 once and for all, that privilege is the dominant principle, so that even at the expense of not providing the whole truth to the tribunal, a person must not be compelled to reveal what he has said to his lawyer or what his lawyer has said to him. One may ask why, as a matter of policy, that general principle should not apply also to the exercise of Revenue investigation powers, because, of course, the consequence of the Inland Revenue getting privileged material is that they know what has passed between a taxpayer and his lawyer. It is a very controversial policy area.

In the United Kingdom, the law in this area is being influenced by the adoption into our law of the principles of the Human Rights Convention. On the 23rd May 2001, the House of Lords gave judgment in the case

of *R v. The Home Secretary ex. P. Daly* [2001] UKHL 26, a case on prisoners' rights. The Home Secretary lost, and one is tempted to think that judges are nowadays more anxious to protect prisoners' rights than taxpayers' rights. Perhaps they should reflect on where their salaries come from! The appellant, Mr. Daley, is – still – a long-term prisoner, and he challenged the policy regulation which required prison staff to examine legal correspondence during a cell search in the absence of the prisoner whose cell was being searched. Mr. Daley was well-advised and, for the purposes of appeal, he accepted the need for random searches of prisoners' cells. He accepted also that such searches might properly be carried out in the absence of the resident prisoner. And he also accepted the need for prison officers to examine legal correspondence held by prisoners, to make sure that it was legal correspondence and that that correspondence was not used as a convenient hiding place to secrete drugs or illicit materials of any kind or to keep escape plans or records of illegal activity. He accepted all those things: he limited his complaint to the claim that the examination of legal correspondence should ordinarily take place in the presence of the prisoner whose correspondence it was. He just wanted to be there when the prison officers examined the correspondence.

The Home Secretary's evidence, on the other hand, was that examination of prisoners' legal correspondence had always to be carried out in the absence of the prisoner in order to "discourage prisoners from using intimidatory or conditioning tactics to prevent officers

carrying out a full search of possessions." What was meant by "conditioning tactics" was action by which prisoners seek to influence the future behaviour of prison officers. The Home Office evidence went on, "For example, a prisoner might create a scene whenever a particular item was searched intending to cause prison officers not to search it in future on the ground that searching it was more trouble than it was worth" and one can well understand and imagine what might be going on in those circumstances.

The House of Lords decided that the prison policy did indeed infringe the prisoner's common law right to the confidentiality of his privileged legal correspondence. This is for the reason I refer to above – that it inhibited the prisoner's willingness to communicate with his legal adviser in terms of unreserved candour, and that there was a risk, if the prisoner was not present, that officers would stray beyond their limited role in examining legal correspondence. Lord Bingham accepted – and I think this is important – that in an imperfect world there will necessarily be occasions when prison officers will do more than merely examine a prisoner's legal documents, and apprehension that they may do so is bound to inhibit a prisoner's willingness to communicate freely with his legal adviser. At this point one might reflect that if prison officers can be fallible in this respect, cannot tax officials also fail to adhere strictly to their duty to respect the confidentiality of the material they see? The House of Lords then considered the Home Office's justification for the policy, and it objected to its blanket nature. It

held that the Home Office should discriminate on a reasonable basis between those prisoners who were likely to be intimidatory or disruptive or both, and those who were not, and only to search in the absence of prisoners when they reasonably considered them to be disruptive or intimidatory. They had to take a prior reasonable decision as to whether this prisoner was likely to be intimidatory, and only then did they have the justification to override his fundamental right to confidentiality in this way. And on this ground the blanket policy regulation which the Home Office was arguing was declared unlawful in the sense of being *ultra vires* the enabling primary legislation which was s.47 of the Prison Act 1952.

The reason I have discussed this case at such length is that it seems to me to exhibit a radically different judicial attitude from that which we in England have been accustomed to expect in cases of alleged abuse by the Inland Revenue of their section 20 investigation powers. It is also more realistic: its scepticism on the question of whether one can always assume unimpeachable integrity on the part of government officials is quite refreshing. What a change from the tone of the famous dictum routinely cited in judicial reviews cases involving the Inland Revenue that they themselves are in the best position to judge the fairness of their own actions. That comes from the 1985 case of *Preston* [1985] STC 282. And what a change from the attitude of the House of Lords in *TC Coombs* [1991] STC 97, where it held that an inspector seeking to serve a section 20 notice must be presumed to act reasonably, unless it can

be positively proved that he could not possibly be acting reasonably. The House of Lords in the *Coombs* case was willing to take this stance, even though it acknowledged that the pre-condition it was setting could, in practice, never – or hardly ever – be fulfilled. On that basis, the presumption was in practical terms irrebuttable. Incidentally, the very inspector concerned in the *TC Coombs* case was later convicted for accepting bribes and was sent to prison himself.

In considering the right to respect the correspondence under Article 8 of the Human Rights Convention in the *Daly* case, Lord Steyn commented that there was an overlap between the English law approach on judicial review and the Convention approach, and that most cases would be decided the same way whichever approach was adopted. But he did say that the Convention approach, with its emphasis on the need for any infringement of human rights not only to be objectively justifiable on a recognised basis, but also proportional to the needs of the public policy justification, did mean that "the intensity of review is somewhat greater under the proportionality approach". In other words, the threshold for finding abuses is lower under the Convention approach, so you are more likely to get home under the Convention approach than under the traditional English administrative law approach laid down in the old 1948 *Wednesbury* case [1948] 1 KB 223, where the Court has to find that a decision is capricious or absurd before it can intervene.

All of this suggests that the tide may yet turn – at any rate in England – in this field, where hitherto the Inland Revenue have been left very much to their own devices. I believe we are moving away both from blanket defences and from blanket investigatory powers, towards something much more tailored to the specific case in hand. In the *Tamosious* case in 1999, the Court was faced with the problem of what to do when a lawyer who was being raided by the Revenue made a blanket claim saying that all his papers were privileged and protected from seizure. He put up a blanket defence. How was that claim to be tested? The High Court held that the existing section 20 code on raids permitted the Revenue to take with them an independent counsel, who would be on the premises for the purposes of making an on-the-spot adjudication of any privilege issue. The disputed items could properly be taken away, even if a claim for privilege was still maintained in relation to them, provided they were kept in an embargoed state until the person raided had the opportunity to apply to the Court for a binding adjudication. The principal amendment made to section 20 in 2000 was the statutory introduction of a new Revenue power to apply to a judge for a production order, requiring documents to be produced within a specified short period, and there is an express protection from this power for items subject to legal privilege, wherever they may be found – that is, in a lawyer's possession or otherwise. In this way, but only in relation to the exercise of this new power, one of the historical illogicalities of the privilege defence is removed, and this is a very significant policy change in favour of the taxpayer.

Another interesting policy change introduced in 2000 is that before the Inland Revenue can get one of these new production orders from the judge, they must give the person affected the opportunity to appear and be heard at the hearing before the judge when the application for the order is made, so that this is an *inter-partes* hearing rather than the *ex parte* hearing we have traditionally had, where only the Inland Revenue is there before the judge. Although the Inland Revenue have always had certain duties to present a fair and balanced approach, the taxpayer was not there to make sure that this duty was carried out, and in any event the judge only had the Revenue before him. Admittedly, under the 2000 rule this provision for an *inter-partes* hearing can be challenged, and the judge can refuse to hear the taxpayer, but only if the investigation would be prejudiced by his being there.

We might say – in the Revenue's favour – that the 2000 change includes a new provision for the resolution of disputes as to legal privilege, very much along the lines foreshadowed in the *Tamosious* case. The position on the resolution of privilege disputes which applies in relation to the new production order has now also been applied to Revenue raids – not by way of Revenue regulations, but instead by primary legislation in the form of the Criminal Justice and Police Act 2001, which was rushed through Parliament before the recent General Election. Section 50 of that Act expressly empowers the Revenue, under a s.20C raid, to take away material which may or may not be privileged and keep it embargoed. There is a duty to notify the occupier of

what has been taken away, and there is a duty to have procedures in place to get any real disputes as to whether or not any particular documents are privileged before a judge as soon as possible.

The trend which emerges from the recent case law and the legislation passed in reaction to it, is that there is much more awareness that investigation powers which override legal professional privilege cannot be in such blanket terms as have traditionally been regarded as acceptable. It seems to be coming to be recognised as unacceptable, at any rate in theory, for the Inland Revenue to be able to use their powers against anyone and in any circumstances without the possibility of any opposition being voiced, except in reaction to the exercise of the power. There is an awareness in the legislation that any infringement of fundamental rights must, in order to satisfy Human Rights Act requirements, be proportionate for the purposes justifying the infringement, and must therefore be a good deal more fine-tuned.

But on the other hand, the new approach, while recognising the fundamental nature of the rights on legal professional privilege, will not allow privilege to be asserted on a blanket basis, without any comeback from the Inland Revenue. The law now is saying that procedures must be put in place which are appropriate and proportionate, in order to test the claim of privilege and at the same time preserve the confidentiality inherent in privilege documents. The up-coming House of Lords appeal in the *Morgan Grenfell* case (if it happens, and I

hope it will) will therefore be interesting because it will examine and – with luck – rectify the approach of the original section 20 legislation. That legislation dates from 1976, before privilege was recognised as a fundamental common law right in the way that it now is recognised. This case will – with luck – be a resolution of an interesting jurisprudential conflict, but it will be interesting to see whether it does rectify the approach of that original legislation – the Court of Appeal having held in a blanket way that it abolishes the right to privilege except in stated exceptional circumstances, and having also refused, in a blanket way, any opportunity to the person affected to be heard on the matter. That opportunity is now belatedly being recognised by the law as an appropriate and proportional protection against abuse, where Revenue investigatory powers conflict with the fundamental right to privilege.