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Report 67

Tax and Privilege

Legal Professional Privilege and the Commissioner of Inland Revenue's Powers to Obtain Information

October 2000
Wellington, New Zealand

The Law Commission is an independent, publicly funded, central advisory body established by statute to undertake the systematic review, reform and development of the law of New Zealand. Its purpose is to help achieve law that is just, principled, and accessible, and that reflects the heritage and aspirations of the peoples of New Zealand.

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24 October 2000

Dear Minister

I am pleased to submit to you Report 67 of the Law Commission *Tax and Privilege: Legal Professional Privilege and the Commissioner of Inland Revenue's Powers to Obtain Information*.

Yours sincerely

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President

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Minister of Justice
Parliament Buildings
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Introduction

THIS REPORT ADDRESSES the issue of whether in the interests of effective processes of tax assessment there should be a modification (beyond that already contained in the Tax Administration Act 1994 section 20) of the rules protecting from disclosure (and in the present context disclosure in particular to the Commissioner of Inland Revenue) communications between lawyers and their clients. The answer which any individual gives to this question is likely to be determined by his or her civic values and philosophy. The Law Commission well understands that its advice is most helpful if it is unanimous. Commissioners strive for and almost always succeed in reaching agreement. But the nature of the present topic has (unsurprisingly enough) precluded consensus.

So the following report is in two parts. The first part sets out the Commission's report. The second part sets out a minority view. Any advocate prefers to set out background facts in a way that assists his or her argument and to that extent there is some overlap between the two parts. Although there is some repetition, there is however not much. The essential points at issue are those identified in the final paragraph of the summary at the commencement of the statement of the minority view. One is whether it has been established that there is a compelling need to abolish non-litigation privilege in relation to tax matters. On that point one's conclusion depends entirely on the weight to be given to two sets of competing values, namely the need for New Zealand to have a fair and solid tax base on the one hand, and the benefits of the rules that we describe as legal professional privilege on the other. The second point troubling the minority is whether this is an appropriate moment to change the law having regard first to what in the view of the minority is public dissatisfaction with the exercise by the Inland Revenue Department of its statutory powers, and secondly to the likely need to readdress the law of privilege in the context of multidisciplinary practices. Readers are invited to keep these two points of difference in mind as they read what follows.

1 Report

THE COMMISSIONER'S POWERS GENERALLY

1 NEW ZEALAND'S TAX SYSTEM is founded on taxpayer self-assessment and voluntary compliance, but the obligations of taxpayers to make returns¹ are complemented by various powers entitling the Commissioner of Inland Revenue to call for information from any person and to inspect records.² The Privy Council has observed that:

The whole rationale of taxation would break down and the whole burden of taxation would fall only on diligent and honest taxpayers if the Commissioner had no power to obtain confidential information about taxpayers who may be negligent or dishonest.³

To the same effect was the judgment of the Court of Appeal in the same case:

For obvious reasons the Commissioner cannot be totally reliant on a taxpayer's willingness to comply honestly and accurately with the reporting requirements of the legislation and will often have regard to "other information" obtained from third parties.⁴

The matter was recently expressed by a select committee in these terms:

The department is bound to enforce compliance on the part of all taxpayers. Not to do so would seriously damage the integrity of the tax system and undermine the system of voluntary compliance. The extent of the Commissioner's powers is necessary to ensure that reluctant

¹ In the case of income tax returns the obligation is to be found in the Tax Administration Act 1994, s 33.

² The Tax Administration Act 1994, ss 16–19. Section 15B(e) records the taxpayer's obligation to disclose to the Commissioner in a timely and useful way all information (including books and records) that the tax laws require the taxpayer to disclose.

³ *New Zealand Stock Exchange v CIR* [1992] 3 NZLR 1, 4.

⁴ *New Zealand Stock Exchange v CIR* [1990] 3 NZLR 333, 336 per Richardson J.

taxpayers meet their obligations. Those powers ensure that taxpayers who willingly pay their tax are not disadvantaged or required to pay a disproportionate share of the tax burden.⁵

There should also be noted in this context the terms of the Tax Administration Act 1994 section 6A(3):

- (3) In collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to—
 - (a) The resources available to the Commissioner; and
 - (b) The importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
 - (c) The compliance costs incurred by taxpayers.

The New Zealand Law Society, in its formal written submission to the Law Commission on a draft of this report, took issue with the Commission's use of the term *voluntary compliance*. The ground advanced for such criticism was that "Tax is not voluntary, it is an obligation imposed by the state". *Voluntary compliance* is (as appears from the select committee report and the statutory provision just quoted) the term customarily employed. While taxpayers' obligations are indeed imposed by statute, it seems to the Commission that *voluntary* is as good an adjective as any to distinguish the behaviour of those who dutifully comply with their statutory obligations from that of those against whom the various statutory coercive powers need to be invoked.

THE EFFECT OF SOLICITOR-CLIENT PRIVILEGE ON THE COMMISSIONER'S POWERS

- 2 In 1954 a majority of the Court of Appeal in *C I R v West-Walker*⁶ held in relation to a forerunner of the Tax Administration Act 1994 section 17 that it must be construed as subject to the privilege affecting solicitor-client communications. The response of the legislature was in 1958 to insert section 16A into the Inland Revenue Department Act 1952. Section 20 of the Tax Administration Act 1994 is the current descendant of section 16A. The purpose of

⁵ Finance and Expenditure Committee *Inquiry into the Powers and Operations of the Inland Revenue Department: Report of the Finance and Expenditure Committee* [1999] AJHR, I.31, 13.

⁶ [1954] NZLR 191.

section 16A was, while preserving the *West-Walker* decision, to exempt trust accounts and other financial records. We set out section 20 in its current form in full as follows:

20. Privilege for confidential communication between legal practitioners and their clients—

- (1) Subject to subsections (2) and (3), any information or book or document shall, for the purposes of sections 16 to 19, [143 (1) (b), 143A (1) (b), 143B (1) (b), and 143F], be privileged from disclosure, if—
 - (a) It is a confidential communication, whether oral or written, passing between—
 - (i) A legal practitioner in the practitioner’s professional capacity and another legal practitioner in such capacity; or
 - (ii) A legal practitioner in the practitioner’s professional capacity and the practitioner’s client,—
whether made directly or indirectly through an agent of either; and
 - (b) It is made or brought into existence for the purpose of obtaining or giving legal advice or assistance; and
 - (c) It is not made or brought into existence for the purpose of committing or furthering the commission of some illegal or wrongful act.
- (2) Where the information or book or document consists wholly or partly of, or relates wholly or partly to, the receipts, payments, income, expenditure, or financial transactions of a specified person (whether a legal practitioner, the practitioner’s client, or any other person), it shall not be privileged from disclosure if it is contained in, or comprises the whole or part of, any book, account, statement, or other record prepared or kept by the legal practitioner in connection with a trust account of the legal practitioner within the meaning of section 2 of the Law Practitioners Act 1982.
- (3) Where the information or book or document consists wholly or partly of, or relates wholly or partly to investment receipts (being receipts arising or accruing on or after 1 April 1975 from any money lodged at any time with a legal practitioner for investment) of any person or persons (whether the legal practitioner, the practitioner’s client or clients, or any other person or persons), it shall not be privileged from disclosure if it is contained in, or comprises

the whole or part of, any book, account, statement, or other record prepared or kept by the legal practitioner in connection with a trust account of the legal practitioner within the meaning of section 2 of the Law Practitioners Act 1982.

- (4) Except as provided in subsection (1), no information or book or document shall for the purposes of sections 16 to 19, [143 (1) (b), 143A (1) (b), 143B (1) (b), and 143F] be privileged from disclosure on the ground that it is a communication passing between one legal practitioner and another legal practitioner or between a legal practitioner and the practitioner's client.
- (5) Where any person refuses to disclose any information or book or document on the ground that it is privileged under this section, the Commissioner or that person may apply to a District Court Judge for an order determining whether or not the claim of privilege is valid; and, for the purposes of determining any such application, the District Court Judge may require the information or book or document to be produced to the District Court Judge. An application under this subsection may be made in the course of an inquiry under [section 18] to the District Court Judge who is holding the inquiry.
- (6) Subject to subsection (3), this section shall apply to information, books, and documents made or brought into existence whether before or after the commencement of this Act.
- (7) In this section, "legal practitioner" means a barrister or solicitor of the High Court, and references to a legal practitioner include a firm in which the practitioner is a partner or is held out to be a partner.

It should be noted that although the exception in section 20(1)(c) excluding from the privilege documents brought into existence for a dishonest purpose is clearly desirable as a matter of policy and is consistent with the general law of legal professional privilege, in practice the withholding of such material in reliance on a claim to privilege is likely to prevent such material ever coming to light. So the exception is not the weapon against dishonesty it may be imagined to be.

SOLICITOR-CLIENT PRIVILEGE IN LITIGATION

- 3 The privilege against disclosure of communications between lawyer and client dates from Elizabethan times. It was initially confined to

communications for the purposes of litigation, and its rationale was identified as the fact that lawyers are needed for the efficient conduct of litigation and the further fact that, that being so, a litigant must be able to give a candid account of his position to the lawyer whom he consults without the risk of his confidences being revealed. Because this aspect of the law of privilege is not infrequently described in rhetorical terms of lofty principle,⁷ it seems necessary to emphasise the workaday and utilitarian reason for the protection. Legal professional privilege is not an end in itself but was devised to enable the Court system to run smoothly. The courts cannot function effectively without lawyers to conduct litigation. Lawyers cannot conduct litigation effectively unless communications between them and their clients are protected from disclosure. One statement of this rationale is by Jessel MR:

The object and meaning of the rule is this: that as, by reason of the complexity and difficulty of our law, litigation can only be properly conducted by professional men, it is absolutely necessary that a man, in order to prosecute his rights or to defend himself from an improper claim, should have recourse to the assistance of professional lawyers, and it being so absolutely necessary, it is equally necessary, to use a vulgar phrase, that he should be able to make a clean breast of it to the gentleman whom he consults with a view to the prosecution of his claim, or the substantiating [of] his defence against the claim of others; that he should be able to place unrestricted and unbounded confidence in the professional agent, and that the communications he so makes to him should be kept secret, unless with his consent (for it is his privilege, and not the privilege of the confidential agent), that he should be enabled properly to conduct his litigation. That is the meaning of the rule.⁸

⁷ Examples are Dickson J's observation in *Solosky v The Queen* (1979) 105 DLR (3d) 745, 760 that "the right to communicate in confidence with one's legal advisor is a fundamental civil and legal right, founded upon the unique relationship of solicitor and client" or Deane J's description of the preservation of solicitor-client confidentiality as "a fundamental and general principle of the common law" (*Baker v Campbell* (1983) 153 CLR 52, 117). Contrast the down-to-earth approach of the English Court of Appeal in *Jones v GD Searle & Co* [1979] 1 WLR 101. That Court had no difficulty in construing a Limitation Act provision as requiring an intending plaintiff seeking the indulgence of an extension of time to disclose the general effect of legal advice received.

⁸ *Anderson v Bank of British Columbia* (1876) 2 Ch D 644, 649.

THE PRIVILEGE EXTENDED

- 4 During the nineteenth century the privilege was extended to communications between client and lawyer even though no litigation was contemplated. In what was perhaps the earliest case⁹ Lord Chancellor Brougham seems to have justified the extension of the privilege on the basis that *any* transaction can end up the subject of Court proceedings:

If the privilege were confined to communications connected with suits begun, or intended, or expected, or apprehended, no one could safely adopt such precautions as might eventually render any proceedings successful, or all proceedings superfluous.¹⁰

The issue continued to be contested and was not finally settled until 40 years later by the case of *Minet v Morgan*.¹¹ Even modern explanations of the rationale attaching to solicitor-client communications where there is no litigation, either imminent or on foot, fall back on the not entirely convincing observations of Lord Chancellor Brougham already quoted.¹² The Law Commission's 1994 discussion paper *Evidence Law: Privilege* (NZLC PP23) records reservations as to whether there exists justification for non-litigation privilege (paragraphs 130–167).¹³

THE LAW COMMISSION'S ROLE

- 5 The Law Commission's Report 55 *Evidence* published in 1999 necessarily deals with privilege in general and legal professional privilege in particular.¹⁴ The report of the Commission of Inquiry into Certain Matters Relating to Taxation (known as the Wine-Box Inquiry) had been published in 1997. At pages 1.5.26 to 1.5.31, that Commission records various difficulties that arose with privilege in the course of its inquiries. Its purpose in doing so was to record the

⁹ *Greenough v Gaskell* (1833) 1 My & K 98, 34 ER 618.

¹⁰ Above n 9, 103 and 621.

¹¹ (1873) 8 Ch App 368.

¹² Law Reform Committee (England and Wales) 16th Report *Privilege in Civil Proceedings* Cmnd 3472 (HMSO, London, 1969); The Law Reform Commission *Evidence* Report No. 26 (interim) (Australian Government Publishing Service, Canberra, 1985) vol 1, para 877.

¹³ The discussion paper's proposal in this connection and its non-adoption in the Commission's final report are discussed in para 18.

¹⁴ Law Commission *Evidence: NZLC R55* vol 1 *Reform of the Law* (Wellington, 1999) ch 11.

difficulties which can and do arise in obtaining documents in response to notices. At pages 3.1.61 to 3.1.63, the Wine-Box Inquiry set out its conclusion as to claims of legal professional privilege in the context of the Inland Revenue Commissioner's powers to obtain information. The Commission concluded:

The view of the Commission is that the privilege should be abolished. Such a course will undoubtedly have many opponents and extensive consultation will need to be held with the Law Commission, the IRD and professional and commercial bodies during the course of which the various arguments for and against abolition can be examined and considered in detail.

6 In the light of this expression of opinion, the Law Commission as part of its work on its *Evidence* report set in train a consideration of the relevant issues. It held consultations with lawyers and chartered accountants interested in the field. The Commissioners having the carriage of this part of the *Evidence* project formed the tentative view that legal professional privilege should not entitle taxpayers to resist requirements for disclosure of communications coming into existence up to the date when the taxpayer adopts the stance that seems to him appropriate in a particular case, a point of time that can be identified by reference to the date on which his return has been filed.¹⁵ In respect of communications thereafter a taxpayer is entitled to the protection available to any litigant. One method of achieving this reform would be the substitution for the Tax Administration Act 1994 section 20(1)(b) of some such words as:

(b) It is made or brought into existence for the purpose of obtaining or giving legal advice or assistance in relation to the subject matter of a tax return; and

(ba) It is made or brought into existence after the date that the tax return has been furnished under Part III of this Act;

THE MCKAY COMMITTEE

7 Before we could finish this job there was appointed under the chairmanship of the Rt Hon Sir Ian McKay a committee of experts on tax compliance. We assumed from that committee's terms of reference that the question of section 20 privilege would be dealt with by that committee and so put the matter aside. When, however, the report of the McKay Committee¹⁶ became available

¹⁵ This is the approach of the Tax Administration Act 1994, s 141B(6).

¹⁶ *Tax Compliance: Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance* (Wellington, December 1998).

the Law Commission found that the parcel had passed back to it. The committee indicated general agreement with what it understood that the Law Commission was proposing:

The Law Commission's proposals remain in draft form and have not been published. The committee would have no quarrel with what the Law Commission is proposing. (paragraph 9.58)

but said:

The committee does not make any final recommendation on the scope of the existing legal professional privilege rule applying in tax matters, because it would prefer the government to refer to the more detailed work undertaken by the Law Commission, which has had more time to consider this issue than has the committee. (paragraph 9.59)

By this time it was too late to include any concluded view on this topic in the Law Commission's *Evidence* report. That is not of itself a matter of concern, because any change in the law would involve an alteration not to the Commission's proposed *Evidence Code* but to the Tax Administration Act 1994, and dealing with the present topic separately enables a more discursive treatment than had the topic been dealt with as one point arising in the course of a general rationalisation and codification of the law of evidence. The draft evidence code contained in the *Evidence* report restates the law of legal professional privilege, but the report makes it plain that its recommendation on this point is subject to a supplementary report on legal professional privilege in the context of taxation to be issued in the future.¹⁷ The observation in paragraph 31 of the minority statement:

As recently as August 1999 this Commission supported retention of legal professional privilege as part of the existing general law.

needs to be read with this qualification in mind. It has been confirmed to us that the Treasury and the Inland Revenue Department will look to this report in advising the government on possible legislative changes.

OTHER EXAMPLES OF SUBORDINATION OF PRIVILEGE

- 8 We have already in paragraph 3 observed that the origin of legal professional privilege is simply the establishment of a mechanism to help make the Court system work properly. In our view the matter is

¹⁷ Law Commission, above n 14, para 259.

not one of religiously applying an immutable rule. There is ample precedent for the subordination of privilege to wider considerations of public policy. It is clear, for example, that the Commissioner's statutory powers to obtain information override the privilege against self incrimination,¹⁸ yet as observed by Stanton J dissenting in *West-Walker*:

I cannot think that the rule of evidence relating to privileged communications is of any higher status than the similar rule against requiring a witness to incriminate himself.¹⁹

As already noted in paragraph 2, the solution adopted by the legislature in section 20 was one that to a degree encroached on solicitor-client privilege in a non-litigious context. A similar approach was adopted in 1983 by the Committee of Inquiry into Solicitors Nominee Companies,²⁰ which was essentially concerned with the use of such companies for money-laundering. That committee drew a distinction between communications relating to litigation and other solicitor-client communications (“on our perception of the public interest we would not attribute the same need for protection to those [Trust Account and Nominee Company] records as in our view rightly attaches to litigation-related advice and assistance” (paragraph 6.22)). The committee concluded (paragraph 6.23):

We consider that the same broad law enforcement considerations underlying [Summary Proceedings Act 1957] s 198 justify removing the exception in so far as it protects solicitors trust account and nominee company records; in the same way as the public interest in the proper reporting and assessment of income for tax purposes overrides any protection afforded to those records by the doctrine of legal professional privilege.

Subsequently there were enacted in 1985 the Evidence Amendment Act (No. 2) 1980 section 35A and the Summary Proceedings Act 1957 section 198A. The Serious Fraud Office Act 1990 section 24 is a comparable provision. The High Court of Australia was prepared to override solicitor-client privilege and to require a solicitor to disclose an address despite his client's instructions not to do so, where this was necessary to enable enforcement of a custody order (*Re Bell, ex parte Lees* (1980) 146 CLR 141). Each of the examples

¹⁸ *Singh v CIR* (1995) 17 NZTC 12, 471.

¹⁹ *CIR v West-Walker* [1954] NZLR 191, 216.

²⁰ ILM Richardson (Chairman), MF Dunphy and RC Pope *Report of the Committee of Inquiry into Solicitors Nominee Companies* (Government Printer, Wellington, 1983, H.5).

discussed in this paragraph is a pointer we think toward the correctness of the proposition that solicitor-client privilege in a non-litigious context is not to be regarded as so sacrosanct that it cannot in appropriate cases be set aside in the public interest. The minority statement urges at great length that each of these examples is distinguishable in one way or another from the reform proposed. But we cite these examples to support the contention that the privilege can properly be set aside in appropriate circumstances. We do not suggest that they cast any particular light on the question of whether in the present context the circumstances are or are not appropriate to the overriding of the privilege that is proposed.

THE ISSUE

- 9 Would the Commissioner of Inland Revenue's powers to obtain information work better if section 20 were amended in the sense that we propose in paragraph 6? The Wine-Box Inquiry had no doubt as to the answer, and the plausibility of its conclusion was not challenged by the very experienced McKay Committee.²¹ Even leaving these views to one side, on the face of it the removal of an obstruction to the power to require information must enable the power to work more smoothly. This is perhaps most obviously so where the rights and obligations of the taxpayer are dependent on his state of mind at the material time as they are for example in a determination of whether personal property "was acquired for the purpose of selling or otherwise disposing of it" in the context of the Income Tax Act 1994 section CD 4. The Commissioner in judging the legitimacy of tax-induced arrangements is in our view entitled to all relevant information including communications between taxpayers and their legal advisers.
- 10 The New Zealand Law Society urged on us the view that privilege should not be seen as an obstruction to the Commissioner's information-gathering powers:

²¹ It can fairly be said that the reasons for the Wine-Box Inquiry's recommendation on this point are not articulated with any cogency, and that to the extent that the Inquiry relied on instances advanced by a Mr Nash, a senior Inland Revenue Department officer, those instances suggest a lack of gumption on the part of the Department rather than any inadequacy in the law. It is for this reason that, as the balance of the report should make clear, the Wine-Box Inquiry recommendation is treated in this report as an item in the chronology necessarily to be referred to rather than as an exhaustive source of supporting argument. The essence of what we suggest is the public good to be served by the amendment is set out in paras 15 and 16 below.

The Commissioner's information gathering powers are not being obstructed, rather the Commissioner does not have the power to obtain privileged communications in the first place.

This seems unhelpful in the context of a discussion as to whether the existing definition of the Commissioner's powers should be altered to give him access to material at present withheld from him on a claim of privilege. The Society further urges that this is a citizen versus state situation:

The issue is one of balancing competing interests. The interests of the state and the interests of the individual.

Such a formulation seems more populist than precise. Taxation obligations are imposed by an elected Parliament. Performance of those obligations by each taxpayer is as much in the interest of other taxpayers as of the state. Because the taxpayer has the comprehensive knowledge of his financial position that the Commissioner does not, it is the taxpayer who is in the position of strength. The taxpayer holds all the cards, and what this report discusses is which cards the taxpayer should be required to lay face up on the table.

TAX IS SPECIAL

- 11 It is sometimes argued that to limit privilege in relation to taxation advice is wrongly to single out one set of state-imposed obligations:

Much of the law relating to the Securities Act 1978, the Commerce Act 1986 and the Companies Act 1993 also relies on voluntary disclosure by persons. It has not been suggested, however, that they should be deprived of their right to consult solicitors in confidence.²²

There are two answers to this. First that there is no logical reason why any evidential or other legal rule should apply in precisely the same way to every class of transaction. It is nothing to the point that other situations may exist outside the context of the present discussion in which the privilege should also be restricted. Secondly, tax is different. The existence of a solid tax base is essential to the efficient functioning of a developed state. In considering New Zealand in the year 2000, we need to keep clearly in mind the extent of foreign ownership of New Zealand industry and the ease and speed with which funds can today be moved around the globe.

²² Civil Litigation & Tribunals Committee, New Zealand Law Society "Professional Privilege in Tax Matters" (1998) Lawtalk 496. See also the minority statement, para 50.

It is all too easy for a foreign-owned corporation so to manipulate its accounts as to diminish tax liability to a particular state in which it operates:

I also think it is a grave mistake to underestimate the importance of the growth of crime, corruption and tax evasion as features of globalisation. They are deforming the character of international capitalism and undermining the long-run financial viability of some taxes and thus some states, which the web will exacerbate.²³

The Commissioner of Inland Revenue needs all the help he can get.

PERCEPTIONS OF FAIRNESS

- 12 New Zealand's taxation system relies on voluntary compliance. This is a thrifty approach in the sense that it keeps compliance costs down. Voluntary compliance is affected by taxpayers' perceptions of fairness. It is important that taxpayers A to Y should not be discouraged from voluntary compliance by the belief that taxpayer Z is assisted in concealing his non-compliance by a rule as to privilege initially devised for an entirely different purpose (the proper functioning of the courts), and having as its principal relevant effect an interference with the performance by the appropriate officer of state of his duty to enquire and to investigate.

PRIVILEGE AS PROMOTING LAWFUL CONDUCT

- 13 We do not quarrel with the proposition that obtaining taxation advice enables taxpayers to fulfil their legal obligations. The New Zealand Law Society urged that:

Tax advice is obtained to ensure compliance with the law, rather than non-compliance. As with all other areas of law there may be no discrete or obvious answer as to how taxation laws apply to a particular factual matrix. So advice obtained will consider competing arguments. Having regard to those arguments, the advice may conclude that a taxpayer may take a tax position in conformity with the law. This is compliance with the law. Similarly, advice received as to the manner in which a commercial transaction can be structured in a tax effective manner, within the statutory and case law principles, cannot constitute

²³ Will Hutton in Will Hutton and Anthony Giddens (eds) *On the Edge: Living with Global Capitalism* (Jonathan Cape, London, 2000) 6.

non-compliance with the law. To enquire, examine and receive advice as to how the law applies is entirely consonant with the objective and purpose of the privilege rule.²⁴

(If this is an accurate depiction of the process one is left wondering what it is that the Society believes that taxpayers have to hide.) We do not accept the proposition that the taxpayer with nothing to hide will not be as candid in his dealings with his adviser if there is no privilege (which is currently the position if the adviser is not a lawyer) as he is where the communication is privileged. Moreover there can be non-compliance that is not wilful. (The question of whether non-compliance is wilful is relevant only to penalty.) It is, in the end, the Commissioner (subject to the various rights of review and appeal) who has the statutory obligation to decide whether there has been compliance, not the tax adviser. In performing that function, the Commissioner is likely to be assisted by the very type of material that the Society refers to, simply because it will permit a clearer understanding of the stratagem under investigation.

CONSEQUENCES OF THE REFORM PROPOSED

- 14 There are no hard data in reliance on which conclusions can be drawn as to the effect on the conduct of taxpayers of the shifting of the privilege boundary proposed in this report. There is, however, the concrete fact that the provision of the taxation advice is shared between lawyers (whose clients can invoke privilege) and accountants and other advisers (whose clients cannot). The fact that there is no discernible difference between the conduct of taxpayers who obtain their advice from lawyers and taxpayers who obtain their advice from other sources suggests that the reform proposed will have no effect on taxpayer conduct. The most that can be suggested is that the reform may, like other improvements in enforcement machinery (breathalysers, speed cameras), make taxpayers more law-abiding. This is not the basis on which the change is advocated. A paper *Privilege in Tax Investigations: A Law and Economics Analysis* was commissioned from Chen & Palmer by the Treasury following the recommendation of the Wine-Box Inquiry referred to in paragraph 5 and completed in September 1998. It seems to us that the analysis in that paper is flawed by a

²⁴ A similar point was made by the Institute of Chartered Accountants in its submission.

failure to make use of the parallel situation of taxpayers advised by non-lawyers as a yardstick against which to measure speculations as to the effect of removing or limiting the privilege on taxpayer conduct. In particular, we are unconvinced by suggestions that removal of the privilege would result in a flight of tax advisers from New Zealand to jurisdictions where privilege was available, with the consequence that small- to medium-sized taxpayers for whom it will be uneconomic to seek taxation advice abroad will be disadvantaged in a way that larger taxpayers are not. This is not an accurate depiction of the current position in New Zealand in relation to taxpayers unable to invoke privilege because their advisers are not lawyers, and it seems to us singularly unlikely that it accurately prophesies what would be the position in relation to taxpayers who receive taxation advice from lawyers were the privilege that they may currently claim be removed or modified. Moreover, the Commissioner would have power to call for the information from the taxpayer whether the geographical situation of the adviser was Te Puke or Timbuktu.

- 15 We regard it as axiomatic that the public interest is served by the Commissioner of Inland Revenue performing the duty imposed on him by the Tax Administration Act 1994 section 6A(3):

To collect over time the highest net revenue that is practicable within the law.

This is because:

- the fisc benefits when returns from tax are maximised;
- other taxpayers benefit, who might otherwise be required to make up the shortfall; and
- the removal of any perception that some taxpayers are not pulling their fiscal weight removes a disincentive to voluntary compliance.

The limitation of privilege that we propose will assist the performance of this duty:

- perhaps as an encouragement to improved voluntary compliance (but we place no great weight on this); and
- by facilitating the obtaining by the Commissioner of information that would help him to perform his statutory obligations.

- 16 There is, we suggest, a further public benefit to be obtained from the reform we propose. To the extent that a taxpayer orders his affairs (quite legally) to exploit a loophole or employ some other tax-

minimising stratagem, access by the Commissioner to the advice given to the taxpayer will bring more swiftly to the notice of the Commissioner the existence of such loophole or the state of the law that made such stratagem possible. This will put the Commissioner in a position promptly to recommend statutory changes which would close the loophole or defeat the stratagem should Parliament be minded to adopt them. If this early response deters some taxpayers from incurring the cost of devising and implementing such schemes then so much the better.

ARGUMENTS AGAINST

17 We refer to further arguments against the change in the law that we propose which are, as we understand them, as follows:

- A competent commercial lawyer will advise his client to construct a transaction, where this is possible, in the way that attracts the least tax liability. There is no impropriety in this. Because in practice tax and other advice are not disentangled, the amendment proposed will, it is claimed, confer on the Commissioner an excessive knowledge of the taxpayer's affairs. We do not agree. Disclosure to the Commissioner is not disclosure to the world; those with these fears should study the secrecy provisions of Part IV of the Tax Administration Act 1994 and the relevant offence provisions of the same statute (section 143C, for example, subjects Departmental officers in breach of the secrecy obligation to a maximum penalty of six months imprisonment, a fine of \$15 000, or both). Sections 6(1) and 6(2)(c) and (e) impose an express obligation on ministers and officials to use their best endeavours to protect "the integrity of the tax system" and define that term to include both the rights of taxpayers to have their individual affairs kept confidential and the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers.
- Such a change in the law it is argued will result in a retreat by legal advisers from giving written advice or will lead legal advisers, knowing that Departmental officers will be reading their advice, to express it in terms more optimistic of success than is warranted. The simplest answer to this contention perhaps is to point out that chartered accountants and other taxation advisers who are not lawyers seem to function well enough without the privilege. In any event under the statute the Commissioner may require the provision of information in

writing where no records are available and the information sought is exclusively in a person's mind.²⁵

- It has been said that the Inland Revenue Department is not to be trusted with the extension to its powers that we propose. The New Zealand Law Society puts it that:

The public believe the IRD frequently abuses its powers and protection is needed from that abuse.

As will be seen, a similar view has commended itself to the author of the minority statement. We have considered the report of the Finance and Expenditure Committee on its "Inquiry into the Powers and Operations of the Inland Revenue Department"²⁶ and have considered the Government Response under Standing Order 248(1). It is true that the select committee's report refers to negative perceptions as to the Department's exercise of its powers. It is, however, also true that the committee finds the Department's powers (including its information-gathering powers) to be generally appropriate and not excessive when measured against those existing in other jurisdictions.²⁷ The committee's view of the reasons for the existence of the powers has already been quoted at length in paragraph 5. There seems to be no reason for concluding that the suggested "negative perception" is referable to the exercise of the specific powers discussed in this report. Moreover, in relation to the specific matters discussed in the present report, reference needs to be made to the Tax Administration Act 1994 section 17(A) and particularly to section 17(A)(8), the effect of which is that the District Court will only enforce an application by the Commissioner for production of information if it is satisfied that the information is likely to be relevant for a purpose relating to the administration or enforcement of a tax law. Even if (which is not accepted) the Commissioner of Inland Revenue is untrustworthy, the modification of the privilege protection that is proposed will be subject not to his determination, but to that of a District Court Judge.

- The New Zealand Law Society submitted to us:

Given globalisation of economies, it is important that legal trends, particularly as they relate to business, remain similar. Closer

²⁵ *New Zealand Stock Exchange v C I R* [1990] NZLR 333, 338.

²⁶ Finance and Expenditure Committee, above n 5.

²⁷ Finance and Expenditure Committee, above n 5, 13–14.

economic relations with Australia mean that it is even more important to seek to conform with events in Australia. Recently the Australian High Court extended the scope of legal privilege in Australia to bring it into line with what it viewed as the trends in the rest of the world. It would be a retrograde step to move away from the harmonisation of the business environment between the two countries.

The Australian High Court decision referred to is (we assume) *Eso Australian Resources Ltd v Federal Commissioner of Taxes* [1999] ALR 123, which turns on the narrow point of whether the test for legal professional privilege in the case of documents prepared for the purpose of obtaining legal advice was that such proposal was the sole or merely the dominant purpose for which the document was prepared. This decision casts no light on the issues discussed in the present report. A more cogent analysis than that proffered by the Society would be needed to establish that closer economic relations with Australia are affected by the existence of differences between the two jurisdictions in relation to the aspect of their fiscal arrangements discussed in this report. Like considerations apply to paragraph 29 of the minority statement.

- The minority statement raises the question of multidisciplinary practices as does the New Zealand Law Society. It does not seem to this Commission that this matter tells in any way against the specific proposals contained in this report. That there is a question as to the privilege that should be available to the clients of a multidisciplinary firm which includes solicitors, which question will have to be resolved if in the future such firms are permitted by the legislature, does not seem to us a reason for holding up the limited reform that this report proposes. Our own suggested solution is already to be found in the careful distinction between the privilege available to what is called an employed legal adviser and that available to other legal advisers in the proposed section 55(3) of the Evidence Code.²⁸

18 We recommend that the Tax Administration Act 1994 section 20 be amended in the sense proposed in paragraph 6.

²⁸ Law Commission *Evidence: NZLC R55 vol 2 Evidence Code and Commentary* (Wellington, 1999) 146.

PERSONS ENTITLED TO CLAIM THE PRIVILEGE

- 19 In its 1994 discussion paper *Evidence Law: Privilege* (NZLC PP23), the Law Commission floated the idea of extending legal professional privilege to all those whose business it was to give legal advice, whether or not the adviser was qualified to practise law. But, uneasy at extending an absolute privilege to communications with any dispenser of legal advice, who might not be subject to ethical restraints such as those to be found in the code of ethics to which lawyers are subject, the Commission proposed that the court should have a power to override the privilege in the interests of justice (paragraphs 130–167). In its final report (*Evidence* NZLC R55 (1999), paragraph 253) the Commission abandoned this proposal. The better view is that if privilege is to do its job of promoting client candour it needs to be absolute. In addition, there seems to be a substantial risk that litigation of any magnitude could become bogged down in interlocutory applications for the privilege to be overridden if the discretion were enacted.
- 20 In its submission to us on a draft of the present report, the Institute of Chartered Accountants of New Zealand recalled the Law Commission’s 1994 proposal for a test based on function rather than status. The Institute opposed the restriction of the privilege proposed in the present report and advocated instead an extension of the existing privilege to other persons giving taxation advice.
- 21 Under the Taxation Review Authorities Act 1994 section 16(3)(a), persons other than barristers or solicitors have a right of audience in proceedings before a Taxation Review Authority. It seems to us that where an express statutory right of audience is conferred on non-lawyers they should be entitled to litigation privilege in the same way as lawyers. In the precisely analogous situation under the Employment Contracts Act 1991 section 59, the Employment Court has ruled that such privilege exists.²⁹ It seems to us that as part of the statutory changes that we advocate such privilege should be expressly conferred in respect of proceedings before the Taxation Review Authority and we so recommend.

²⁹ *Fahey v Attorney-General* [1993] 1 ERNZ 161.

PARTICULARISATION AND PRESERVATION OF DOCUMENTS IN RESPECT OF WHICH PRIVILEGE IS CLAIMED

22 We were asked at a late stage to comment on the recommendations of the McKay Committee (paragraph 9.63) that section 20 should be amended in the following respects:

- An amendment should be made to ensure the physical protection of documents for which legal professional privilege is claimed pending judicial determination of the claim's validity.
- An amendment should be made to require the identification of documents for which privilege is being claimed as a condition of obtaining privilege.

On the second of these points what is proposed equates with the present procedural requirements where privilege is claimed as part of the discovery process in a civil action³⁰ and it is entirely logical that it should apply where privilege is asserted in the context under discussion. Without such a requirement it is too easy to cheat. In relation to discovery in civil proceedings, the court has power to interfere in the case of oppression.³¹ There should be power for a District Court Judge on an application made for the purpose, to modify the proposed requirement of identification to avoid the oppression of requiring a listing of a very large number of documents. The first point assumes the existence of a need for protection against tampering and that there are insufficient existing protections. On this point we have not had an opportunity to make inquiry or to consult interested parties and would prefer not to express an opinion.

SUMMARY OF RECOMMENDATIONS

23 Accordingly the Commission recommends:

- that the privilege claimable under the Tax Administration Act 1994 section 20 be confined to litigation privilege defined as indicated in paragraph 6;
- that the privilege so modified be extended to communications with non-lawyer advocates exercising the right of audience conferred by the Taxation Review Authorities Act 1994 section 16(3)(a); and

³⁰ *Guardian Royal Exchange v Stuart* [1985] 1 NZLR 596, 607, per Tompkins J.

³¹ *Christchurch CC v Christchurch Gas Ltd* (1988) 2 PRNZ 609.

- that a claimant to such privilege be required to particularise the documents in respect of which privilege is claimed, subject to a right to apply for relief to a District Court Judge where the volume of papers would make particularisation oppressive.
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Statement of minority
view of Commissioner
Paul Heath QC

SUMMARY

- 24 I DISAGREE WITH THE RECOMMENDATION made by the majority of the Commission that legal professional privilege should be restricted, under section 20 of the Tax Administration Act 1994, to litigation privilege as defined in paragraph 6 of the majority report. I refer to this recommendation of the majority as their primary recommendation.
- 25 I do not favour extension of the privilege within the scope of section 20 of the Tax Administration Act 1994 as it presently stands. However, should the majority's primary recommendation be accepted, I would agree with the recommendation that the privilege be extended to communications with non-lawyers who act as advocates before the Taxation Review Authority. On that premise, I would find it difficult to quarrel with the reasoning set out in paragraphs 19–21 of the majority report.
- 26 I agree with the recommendation of the majority that any taxpayer who asserts the right to claim legal professional privilege as against the Commissioner should be required to particularise the documents in respect of which privilege is claimed. I would go further in some respects on this issue than the majority, and my views on that aspect are set out later.³²
- 27 I disagree with the primary recommendation of the majority on two quite distinct bases, viz:
- I am not persuaded that there is a compelling need to abolish non-litigation privilege in relation to tax matters.

³² See paras 44, 45 and 48 below.

- Having regard both to:
 - recent criticisms of the way in which the Inland Revenue Department has exercised powers under the Inland Revenue Department Acts; and
 - the likely need to readdress the law of privilege in the context of multidisciplinary practices;

it would be inappropriate, in any event, to change the law at this time.

THE MAJORITY'S PRIMARY RECOMMENDATION

General

28 It is now generally accepted that the rationale for legal professional privilege is its assistance to and enhancement of the administration of justice by facilitating the representation of clients by legal advisors. The aim is to keep secret the communications between legal advisors and clients, in an endeavour to induce the client to make full and frank disclosure of relevant circumstances, without fear that those communications will subsequently be made available in evidence if a dispute about the matter on which advice is sought arises. As Stephen, Mason and Murphy JJ said in *Grant v Downs*³³ in the High Court of Australia:

The existence of the privilege reflects, to the extent to which it is accorded, the paramountcy of this public interest over a more general public interest, that which requires that in the interests of a fair trial litigation should be conducted on the footing that all relevant documentary evidence is available.

It can be seen from these comments the recognition of the privilege is, itself, the result of a balancing of competing public policy goals.

29 That policy basis for legal professional privilege was applied recently by the High Court of Australia in a taxation case.³⁴ In Australia, legal professional privilege is reinforced in statutory terms in the Federal jurisdiction by sections 118 and 119 of the Evidence Act 1995 (Cth); the privilege applies, in relation to tax matters, both to litigation and non-litigation privilege. To my mind, a compatible

³³ (1976) 135 CLR 674, 685.

³⁴ *Esso Australia Resources Limited v The Commissioner of Taxation* [1995] ALR 123, see in particular para 35 per Gleeson CJ, Gaudron and Gummow JJ.

approach in matters affecting legal professional privilege and taxation is desirable on the grounds (inter alia) of the close economic relationship between Australia and New Zealand and the likely interaction of some taxpayers with taxation authorities in both countries.

- 30 It is important also to note that the recognition of legal professional privilege has nothing to do with protection of a lawyer. In a case before the European Court of Justice, Advocate-General Warner said:

[the privilege] springs essentially from the basic need of a man in a civilised society to be able to turn to his lawyer for advice and help and if proceedings begin, for representation; it springs no less from the advantages to a society which evolves complex law reaching into all the business affairs of persons, real and legal, that they should be able to know what they can do under the law, what is forbidden, where they must tread circumspectly, where they run risks.³⁵

- 31 As recently as August 1999 this Commission supported retention of legal professional privilege³⁶ as part of the existing general law. If the majority's primary recommendation is to be supported, it is my view that it is necessary to demonstrate a compelling need to abrogate the privilege to the extent suggested. In my view, the starting point for discussion should be the observations of Advocate-General Warner (to which I refer in paragraph 30) and those of Lord Taylor of Gosforth CJ in *R v Derby Magistrates Court, Ex parte B*³⁷ where, after discussing a proposal from an amicus curiae that the privilege should not be absolute, His Lordship said:

But the drawback to that approach is that once any exception to the general rule is allowed, the client's confidence is necessary lost. The solicitor, instead of being able to tell his client that anything which the client might say would never in any circumstances be revealed without his consent, would have to qualify his assurance. He would have to tell the client that his confidence might be broken if in some future case the court were to hold that he no longer had "any recognisable interest" in asserting his privilege. One can see at once that the purpose of the privilege would thereby be undermined.

- 32 Section 20 of the Tax Administration Act 1994 has been set out fully in paragraph 2 of the majority report. It will be seen that the

³⁵ *AM & S Europe Limited v Commission of the European Communities* [1983] QB 878, 913.

³⁶ Law Commission, above n 14, paras 252–256 and 323–324.

³⁷ [1996] 1 AC 487, 508.

term “legal practitioner” has been defined to apply the privilege to a barrister or solicitor of the High Court, including any firm in which the practitioner is a partner or is held out to be a partner.³⁸ This narrow definition of the term “legal practitioner” has denied to the Taxation Review Authority the ability to extend the privilege to non-lawyer advocates, in the way that the Employment Court extended the scope of the privilege to non-lawyers to account for the involvement of non-lawyer advocates in its processes.³⁹

33 The effect of the current legislation is to leave a taxpayer with a “legal practitioner” (as defined) as the only person to whom he or she can turn for confidential tax advice. That legal practitioner is the only person from whom confidential advice can be sought by a taxpayer about what he or she can do under the tax laws, what is forbidden, where the taxpayer must tread circumspectly, and what risks the taxpayer runs through taking any particular course of action.⁴⁰ Making such advice routinely available to the Inland Revenue Department is likely to act as a disincentive to legal practitioners to prepare written advice of the desired quality and extent for the benefit of the client.

34 The law permits a taxpayer to order his or her affairs in such a way as to minimise his or her legal obligations to pay tax, notwithstanding the wide anti-avoidance provisions contained in the Income Tax Act 1994.⁴¹ As Lord Templeman said, when delivering the majority advice of the Privy Council in *Challenge Corporation Limited v Commissioner of Inland Revenue*:

A taxpayer has always been free to mitigate his liability to tax. In the oft-quoted words of Lord Tomlin in *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1, 19, “Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be”.⁴²

Lord Templeman then explained the difference between tax mitigation and tax avoidance. Tax avoidance was described as occurring when a tax advantage was derived from an arrangement

³⁸ Tax Administration Act 1994, s 20(7).

³⁹ Compare Employment Contracts Act 1991, s 59 and *Fahey v Attorney-General* [1993] 1 ERNZ 161.

⁴⁰ Adapted from the observations of Advocate-General Warner in *AM & S Europe Limited v Commission of the European Communities* [1983] QB 878, 915.

⁴¹ See sections OB 1, BG 1, GB 1(1)–(3) and GZ 1.

⁴² [1986] 2 NZLR 513, 561.

whereby the taxpayer reduced his liability to tax without incurring the loss or expenditure entitling the taxpayer to that reduction.⁴³

35 Finally, in the context of the privilege, it must be remembered that the courts have placed limits upon the communications which will be protected as privileged. Two examples follow:

- The communication in question must involve the giving of legal advice. Accordingly, documents which are brought into existence by a solicitor for the purpose of recording transactions in a solicitor's trust account will not be protected by the privilege.⁴⁴
- Where it can be established that a communication which would otherwise be within the ambit of a protected communication has been made in furtherance of a fraudulent design, the privilege cannot be invoked as a basis for refusing to disclose such communications. Where the court is satisfied that a strong prima facie case of fraud has been made out, it will not recognise the privilege and will permit the privileged communications to be adduced in evidence, whether orally or in writing.⁴⁵

The privilege remains the privilege of the client or clients. It can be waived expressly or by implication.⁴⁶ If the privilege can be invoked by two or more joint clients, a waiver by only one of the clients will suffice to allow the (otherwise) privileged communication to be adduced in evidence.⁴⁷

⁴³ Above n 42, 561.

⁴⁴ *Re The Coachman Tavern (1985) Limited* (1990) 5 NZCLC 66,320 and *Re Merit Finance & Investment Group Limited* [1993] 1 NZLR 152.

⁴⁵ *Derby & Co Limited v Weldon (No 7)* [1990] 3 ALL ER 161, applied in New Zealand in *Re Springfield Acres Limited* (5 August 1992) unreported, High Court, Hamilton, M 327/91, Master Kennedy-Grant (evidential threshold of fraud found not to have been passed); *Kupe Group Limited v Seamar Holdings Limited* [1993] 3 NZLR 209 (principle applied to override privilege) and *Matua Finance Limited v Equiticorp Industries Group Limited* [1993] 3 NZLR 650 (CA), 653.

⁴⁶ For examples of cases where the privilege has been impliedly waived, see *Equiticorp Industries Group Limited v Hawkins* [1990] 2 NZLR 175 and *Attorney-General for the Northern Territory v Maurice* (1986) 69 ALR 31 (HCA).

⁴⁷ *Re Konigsberg* [1989] 3 ALL ER 289.

POST-1994 DEVELOPMENTS RELEVANT TO PRIVILEGE

- 36 The question which must be addressed squarely is whether there is a compelling need, demonstrated from events which have occurred since the passage of the Tax Administration Act 1994,⁴⁸ to reverse the law enacted in 1994.
- 37 An analysis of section 20 demonstrates that it was intended to codify the existing law relating to legal professional privilege so that communications which would be protected under the general law continue to be protected against the Commissioner. Section 20(1)(c) preserved the existing law which denies protection of the communication when the communication was made or brought into existence for the purpose of committing or furthering some illegal or wrongful act. The words, on their face, appear to be wide enough to prevent the privilege from disclosure attaching to a communication brought into existence for the purpose of committing tax fraud.
- 38 The question whether legal professional privilege should be abolished in relation to tax matters, or restricted in some way, has been raised in a number of recent publications. In summary form:
- The Organisational Review Committee which reported to the Minister of Revenue (and on tax policy, also to the Minister of Finance) in April 1994⁴⁹ referred to a submission from the New Zealand Society of Accountants (now the Institute of Chartered Accountants of New Zealand) in which it was suggested that privilege should be extended to tax advice given by its members so that they were put on an equal footing with law practitioners.⁵⁰ The Organisational Review Committee considered that it might be appropriate to reconsider professional privilege generally in relation to revenue matters. In particular, it referred to a “growing trend” of “openness in litigation”. The Organisational Review Committee did not, however, regard consideration of *extending* privilege as part of the review which it was undertaking. Rather, it noted that questions of privilege were included in the evidence project then being undertaken by the Law Commission.

⁴⁸ By s 1(2) of the Tax Administration Act 1994, that Act came into force on 1 April 1995.

⁴⁹ *Organisational Review of the Inland Revenue Department* (April 1994).

⁵⁰ Above n 49, 70, para 10.10.

- In the report of the Commission of Inquiry into Certain Matters Relating to Taxation⁵¹ (the Wine-Box Inquiry) views were expressed by the Commissioner, Sir Ronald Davison, that privilege should be abolished in relation to tax matters.
- In the Report to the Treasurer and Minister of Revenue by a Committee of Experts, *Tax Compliance*⁵² (the McKay Committee) the committee discussed legal professional privilege. It noted that the common law doctrine was embodied in section 20 of the Tax Administration Act 1994.⁵³ As noted in the majority report, the McKay Committee referred to the view of the Wine-Box Inquiry that legal professional privilege should be abolished in all tax matters⁵⁴ and noted that the matter was under consideration by the Law Commission.⁵⁵ The McKay Committee expressly said that if the ultimate report from this Commission was to restrict privilege to litigation privilege it would have no quarrel with that recommendation.⁵⁶

39 Of these reports only the Wine-Box Inquiry purports to demonstrate any difficulty with the application of the existing law of privilege in the context of tax collection.⁵⁷ But the McKay Committee expressed some scepticism about evidence given by the Inland Revenue Department to the Wine-Box Inquiry, stating that “some of these practices seem to the Committee so clearly outside the scope of any valid claim to privilege that they are clearly beyond the limits of acceptable professional behaviour”.⁵⁸

40 I think it is important to isolate the precise matters which caused the Wine-Box Inquiry to express the view that the privilege should be abolished. Its report deals with this in two parts, viz:

⁵¹ Commission of Inquiry into Certain Matters Relating to Taxation *Report of the Wine-Box Inquiry* (Department of Internal Affairs, Wellington, 1997).

⁵² *Tax Compliance*, above n 16, 182.

⁵³ *Tax Compliance*, above n 16, 182, para 9.36.

⁵⁴ *Tax Compliance*, above n 16, 186–187, para 9.54.

⁵⁵ *Tax Compliance*, above n 16, 187, paras 9.55–9.59.

⁵⁶ *Tax Compliance*, above n 16, 187, para 9.58.

⁵⁷ *Wine-Box Inquiry*, above n 51, pp 1:5:26–1:5:31 and pp 3:1:61–3:1:63.

⁵⁸ *Tax Compliance*, above n 16, 185, para 9.48. The particular concerns expressed in the Inland Revenue Department evidence before the Wine-Box Commission are set out at para 9.47 of the McKay Committee Report and are reproduced at para 43.

- There were difficulties with the production of documents which, ultimately, were not capable of being protected by legal professional privilege.⁵⁹ Examples given by the Wine-Box Inquiry suggest that some named persons may have sought to delay proceedings by wrongfully claiming the benefit of the privilege in certain cases.
- More generally, claims by taxpayers to legal professional privilege in respect of alleged confidential communications were said to be a source of delay and frustration to the Inland Revenue Department.⁶⁰ The issues were identified by Mr Nash (a senior IRD officer) in his evidence which was set out extensively in the Wine-Box Inquiry report.⁶¹

41 The two aspects identified by the Wine-Box Inquiry amount to the same thing: a concern that legal professional privilege is being used to delay or frustrate the collection of tax. However, the Wine-Box Inquiry did not squarely address the question whether the examples given were sufficient to justify interference with the privilege in all cases. Certainly, the Commissioner did not address the question whether there are better, and alternative, ways of dealing with the particular problems that have been identified.

42 I am of the view that it is inappropriate for this Commission to recommend an abolition of the privilege simply because it would make the Commissioner of Inland Revenue's tasks easier. The question is not whether it would be helpful to the Commissioner to remove the protection of legal professional privilege but whether there is a *need* to remove the privilege.

43 The evidence of Mr Nash (before the Wine-Box Inquiry, on which the Commissioner put much weight) on the question of legal professional privilege contains the following extracts:⁶²

One of the biggest obstacles to IRD *when conducting large corporate investigations* is legal professional privilege

The IRD had a duty to protect the public revenue. As Mr Henry [the Commissioner of Inland Revenue] has said, IRD collects 80 percent of

⁵⁹ *Wine-Box Inquiry*, above n 51, pp 1:5:27–1:5:31.

⁶⁰ *Wine-Box Inquiry*, above n 51, p 3:1:61.

⁶¹ *Wine-Box Inquiry*, above n 51, pp 3:1:61–3:1:63; see para 43 below.

⁶² *Wine-Box Inquiry*, above n 51, pp 3:1:62–3:1:63; I have tried to retain the integrity of the points made by Mr Nash even though I have only cited extracts from his evidence.

the Government's revenue. *The veil of privilege weakens the Department's ability to carry out this duty because of the opportunity it provides for exploitation.* The following examples illustrate the point:

- making privilege claims on materials which are held on a solicitor's file but clearly do not involve matters of an advisory nature;
- taking a restrictive interpretation of the word "control" as it applies to information held by a corporate's solicitors, when faced with a wide-ranging IRD information request;
- removing documents from files made available for inspection and not informing IRD that legal professional privilege has been claimed;
- mixing (or not separating) "transaction documents" with legal advisory papers and claiming a blanket privilege for all documents;
- preventing access to offices where important records may be retained without giving the owner sufficient notice such that a claim of legal professional privilege can be made;
- privilege claims by accountants (whether principals or employees in an accounting firm) by reason of their holding a legal practising certificate; and
- privilege claims by officers of companies by reason of their holding a legal practising certificate.

It raises the issue as to whether privilege should be available to legal practitioners for **non-criminal** matters in the first place. Should there be any privilege in taxation litigation, including review matters, save for public interest immunity (previously crown privilege) and matters coming within the secrecy provisions of the Tax Administration Act 1994? In my experience, lawyers in New Zealand have developed a more aggressive attitude to tax avoidance at least over the last ten years. On the one hand, the New Zealand Law Society is supportive of the open approach to the resolution of disputes whereby "all cards are put on the table" early in the process. On the other hand, however, it seeks to maintain the right to privilege for certain communications. This is inconsistent and out of step with modern trends in dispute resolution.

(Italicised highlighting represents my emphasis; bold highlighting represents Mr Nash's emphasis.)

- 44 Mr Nash completed his evidence by referring to procedural rules that should, in his view, be devised to protect documents between the time the claim for privilege is made and the adjudication on that claim by a court, if privilege was not completely abolished. Mr Nash suggested that rules should be introduced to provide for:

- records not being returned to the client once a section 17 [Tax Administration Act 1994] Notice is served on the lawyer;
- listing of the material for which privilege is claimed;
- sealing of that material to prevent tampering; and
- placement of that material with an independent custodian.⁶³

45 In my view, provided adequate procedural steps are put in place to enable listing of privileged documents and confirming the security of those documents pending any challenge to the privilege by the Commissioner, the observation that “in practice, withholding material in reliance on privilege is likely to prevent any illegal or wrongful act coming to light” significantly overstates the position. In my view, the existing law, which is embodied in section 20(1)(c) of the Tax Administration Act 1994, is workable and allows evidence of advice given in furtherance of illegal or fraudulent acts to be admitted. In short, the current law strikes the right balance between the interests of protecting the privilege (on the one hand) and ensuring that the privilege is not abused to protect fraudulent or illegal acts (on the other). And, in my view, it is a balancing exercise that is required, with the courts being the most appropriate body to conduct the exercise. Any competent investigator should be able (from non-privileged materials) to marshal evidence to demonstrate that the threshold of a strong *prima facie* case of fraud has been met; once that threshold has been met, the privilege will be overturned and the communications disclosed.⁶⁴

46 In my view, there are difficulties with an approach that requires abolition of the non-litigation privilege purely for tax matters. In relation to the evidence given by Mr Nash, I note:

- The opinions of Mr Nash on which the Wine-Box Inquiry Commissioner relied were restricted to obstacles caused to the Inland Revenue Department in large corporate investigations. Nowhere has anyone explained why small- to medium-sized businesses and individuals should forego the right to seek and be given legal advice (which may set out the risks of entering into transactions and their possible tax consequences) without fear of disclosure of such advice to the Commissioner because the Inland Revenue Department perceives obstacles in relation to its investigation of large companies. In that context, it is

⁶³ *Wine-Box Inquiry*, above n 51, p 3:1:63.

⁶⁴ See para 35 and n 45 above.

appropriate to note the observations made by the Finance and Expenditure Committee in its recent *Inquiry into the Powers and Operations of the Inland Revenue Department*⁶⁵ where reference is made to recent legislative changes in the United States of America that shift the burden of proof from the taxpayer to the Secretary to the Treasury in cases involving individuals and small businesses.

- Mr Nash asserts that the “veil of privilege” weakens the Commissioner’s ability to protect the public revenue because of the opportunity it provides for exploitation. Examples of possible exploitation are then given. Leaving to one side the sinister connotations which may be taken from the language employed by Mr Nash, I agree that some of the examples given by Mr Nash demonstrate that the privilege can be abused. But, the fact that the privilege can, *in some cases*, be abused does not make the case for saying that the privilege *should*, in all cases where litigation is not in prospect, be removed as against the Commissioner. I take the view that alternatives exist to control the potential for abuse, such as the proper listing and securing of documents over which privilege is claimed.
- In his evidence, Mr Nash overlooked the fundamental fact that the privilege is that of the client not the legal practitioner. The evidence cited by the Wine-Box Inquiry Commissioner from Mr Nash focuses upon the question whether the privilege should be available to legal practitioners rather than to the client (taxpayer). In my view, the focus should be on the utility of the privilege to the client rather than to the solicitor. In my respectful view, the Wine-Box Inquiry Commissioner may have approached his assessment of the need (or otherwise) for abolition on the wrong legal footing.
- Mr Nash accepts that the import of his evidence before the Wine-Box Inquiry was to query whether privilege should be available for all non-criminal matters. While the general argument that privilege should not apply across the board (that is, in all civil cases) can be made, it is clear that this Commission has already rejected such a wide proposition.⁶⁶

47 A Parliamentary select committee, with terms of reference requiring it to review the powers of the Commissioner of Inland Revenue to

⁶⁵ Finance and Expenditure Committee, above n 5, 16.

⁶⁶ Law Commission, above n 14, para 252–258.

assess and collect income tax pursuant to the Tax Administration Act 1994 and other relevant Acts, recently expressed the view that:

The powers of the Commissioner are similar to those conferred upon tax collectors in similar jurisdictions, such as, Australia, Canada, the United Kingdom and the United States. Furthermore, the department's powers are not excessive when compared to other state agencies which operate in revenue collection and enforcement environments.

While the powers of the Commissioner are generally appropriate, we do consider that some steps need to be taken with respect to the penalties regime and the Commissioner's powers to enter into arrangements with errant taxpayers.⁶⁷

- 48 It is axiomatic to state that legal professional privilege is restricted to communications between legal advisors and clients. One of the reasons that the privilege can be justified is the fact that the legal advisor, as a barrister or solicitor, is an officer of the court who owes duties to the court that transcend duties owed to clients. I have no quarrel with the proposition that a lawyer who is served with a notice to produce documents under section 17 of the Tax Administration Act 1994 should be required to identify the documents over which privilege is claimed and to secure that material pending resolution of any claim as to privilege. An officer of the court who knowingly destroys material or who knowingly raises hopeless arguments about documents being privileged will be subject to the supervisory jurisdiction of the High Court over its officers. The supervisory jurisdiction of the High Court extends to making orders for costs personally against barristers and solicitors if wasted costs have been brought about due to incompetent or unethical behaviour.⁶⁸ The paramount consideration in determining whether to award costs against a barrister and solicitor is the need to do justice in the sense of holding officers of the court accountable for qualifying breaches of their duty to the court.⁶⁹ Furthermore, some of the behaviour to which Mr Nash referred (for example, destruction of documents) is likely to give rise to criminal charges or, at least, to the possibility of the solicitor being struck off the roll for professional misconduct.

⁶⁷ Finance and Expenditure Committee, above n 5, 13.

⁶⁸ See *Harley v McDonald* [1999] 3 NZLR 545 (CA), 562–575 paras 50, 57–58, 80 and 90; see also the judgment of Giles J at first instance: [1999] 1 NZLR 583.

⁶⁹ Above n 68, 562–563, para 50.

49 I note in passing that the reasons given by the majority to restrict the operation of legal professional privilege in relation to taxation matters have not been put forward by the Inland Revenue Department as a reason for restricting the privilege solely in relation to taxation matters. In that regard I refer to Mr Nash's acceptance that the import of his evidence before the Wine-box Inquiry Commissioner was to query whether privilege should be available for all non-criminal matters.

50 While I understand the majority's view that the collective good of the community justifies an approach to the collection of taxation based on "all cards on the table", I believe it is inappropriate to single out taxation as an area in which privilege should be eroded, for the reasons which I have given.

51 My conclusions are, I believe, reinforced by a comparison of section 20 of the Tax Administration Act 1994 with section 24 of the Serious Fraud Office Act 1990 which is in the following terms:

24 Legal professional privilege—

- (1) Except as provided in subsection (2) of this section, nothing in this Act shall require any legal practitioner to disclose any privileged communication.
- (2) The Director may, by notice in writing to any legal practitioner who the Director has reason to believe may have acted for any person who may be connected with any investigation, require that legal practitioner to supply to the Director the last known name and address of that client.
- (3) For the purposes of this section, a communication is a privileged communication only if—
 - (a) It is a confidential communication, whether oral or written, passing between—
 - (i) A legal practitioner in his or her professional capacity and another legal practitioner in such capacity; or
 - (ii) A legal practitioner in his or her professional capacity and his or her client,—
whether made directly or indirectly through an agent of either; and
 - (b) It is made or brought into existence for the purpose of obtaining or giving legal advice or assistance; and
 - (c) It is not made or brought into existence for the purpose of committing or furthering the commission of some illegal or wrongful act.

- (4) Where the information or document consists wholly of payments, income, expenditure, or financial transactions of a specified person (whether a legal practitioner, his or her client, or any other person), it shall not be a privileged communication if it is contained in, or comprises the whole or part of, any book, account, statement or other record prepared or kept by the legal practitioner in connection with a trust account of the legal practitioner within the meaning of section 2 of the Law Practitioners Act 1982.
- (5) Where any person refuses to disclose any information or document on the ground that it is a privileged communication under this section, the Director or that person may apply to a District Court Judge for an order determining whether or not the claim of privilege is valid; and, for the purposes of determining any such application, the District Court Judge may require the information or document to be produced to him or her.
- (6) For the purposes of this section the term “legal practitioner” means a barrister or solicitor of the High Court, and references to a legal practitioner include a firm in which he or she is a partner or is held out to be a partner.

52 Section 24 of the Serious Fraud Office Act 1990 was reviewed in *Beecroft v Auckland District Court*.⁷⁰ It is important to note that legal professional privilege is protected, save for the circumstances in which section 24(2) of the Act applies. That subsection applies only to a requirement that the last known name and address of the client be disclosed. The structure of section 24 of the Act:

- identifies those communications which are truly privileged at common law.⁷¹ This provision is identical in scope to the existing provisions of section 20(1) of the Tax Administration Act 1994; and
- makes it clear that information which merely records financial transactions is not privileged.⁷² That merely restates the law as found in cases such as *Re The Coachman Tavern (1985) Limited*⁷³ and *Re Merit Finance & Investment Group Limited*.⁷⁴

⁷⁰ [1999] 3 NZLR 672.

⁷¹ Serious Fraud Office Act 1990, s 24(3).

⁷² Above n 71, s 24(4).

⁷³ (1990) 5 NZCLC 66,320.

⁷⁴ [1993] 1 NZLR 152.

The object of the Serious Fraud Office Act is, naturally enough, to assist the investigation of fraud. Thus, it is not surprising to find in section 24(3) of the Act an exception for activities that have a fraudulent design; that exception is in precisely the same terms as section 20(1)(c) of the Tax Administration Act 1994.

- 53 Necessarily, if communications of a non-litigation nature between a legal practitioner and client are denied privilege against the Commissioner, such advice will be admissible in both criminal and civil proceedings. I see no reason why, in those circumstances, the tax authorities should be entitled to greater powers than those given to the Serious Fraud Office.

Erosion of the privilege?

- 54 In the majority's report, examples are cited which, it is contended, show that there has been a subordination of privilege to wider considerations of public policy.⁷⁵ I, with respect, differ from my colleagues on the question whether the provisions and cases they cite establish the point they are seeking to make. I deal with the examples given in turn.
- 55 Reference was made to the Committee of Inquiry into Solicitors Nominee Companies.⁷⁶ It is said that committee drew a distinction between communications relating to litigation and other solicitor-client communications which the committee regarded as not requiring the same degree of protection as would apply to litigation-related advice and assistance.⁷⁷ But, with respect, the reason that trust account records are not privileged is because they show a record of transactions rather than a record of legal advice given. The courts, without having to rely upon the broad reasons set out by the Committee of Inquiry, have held that such records are not protected by privilege.⁷⁸ In *Re The Coachman Tavern (1985) Limited*, Anderson J said:

The documents in question record the receipt and disbursements of monies handled by the solicitor on behalf of the clients, with annotations identifying the nature, amount, immediate source and date of monies received and the nature, amount, immediate recipient, and date of monies disbursed.⁷⁹

⁷⁵ See para 8 above.

⁷⁶ Richardson, Dunphy and Pope, above n 20.

⁷⁷ Richardson, Dunphy and Pope, above n 20, paras 6.22–6.23.

⁷⁸ Law Commission, above n 14, paras 252–253.

⁷⁹ Above n 73, 66,213.

A lawyers' client is entitled to have all communications made with a view to obtaining legal advice kept confidential. Whether communications are made to the lawyer himself or to employees, and whether they deal with matters of an administrative nature such as financial means or with the actual nature of the legal problem, all information which a person must provide in order to obtain legal advice and which is given in confidence for that purpose enjoys the privileges attached to confidentiality.⁸⁰

. . . it cannot be claimed that the particular trust account records show anything more than the receipt and disbursement of monies handled by the solicitor on behalf of the relevant clients, with annotations identifying the nature, amount, immediate source and date of monies received with like information in respect of monies disbursed. That is, the document amounts to nothing more than records of the movement of monies in relation to the accounts of an agent who happened to be a solicitor. I cannot find on the information available that such monetary transactions were communications for the purpose of obtaining legal advice, nor that the assistance given in respect thereof was legal assistance rather than assistance given by an agent who happened to be a solicitor.⁸¹

56 It is true that there was conflicting authority in existence at the time that *The Coachman Tavern (1985) Limited* and *Re Merit Finance & Investment Group Limited* were decided.⁸² However, the point has now been firmly resolved in favour of the view that records of the movement of money will not attract the privilege. For that reason, I disagree with my learned colleagues when they put that issue forward as a reason for saying that the privilege has been subordinated.

57 Likewise, I do not see the provisions contained in the Summary Proceedings Act 1957 as assisting the majority view. Indeed, if anything, the very stringent arrangements which must be made in respect of documents seized from the office of a solicitor which may be subject to the privilege suggest that the contrary is true. Those provisions were inserted into the Summary Proceedings Act 1957 after the decision in *Rosenberg v Jaine*.⁸³ The need to provide an

⁸⁰ Above n 73, 66,322–66,323, quoting from *Descôteaux v Mierzwinski* (1982) 70 CCC (2d) 385, 413.

⁸¹ Above n 73, 66,323.

⁸² See, in particular, the discussion of that authority in *Re Merit Finance & Investment Group Limited* [1993] 1 NZLR 152, 156–158.

⁸³ [1983] NZLR 1.

inventory of documents seized from the office of a solicitor⁸⁴ reinforces the need to protect privileged communications. Alternatively, it can be argued that, for the same reasons I have given in relation to the privilege not applying to trust account records generally, the provisions of section 198A of the Summary Proceedings Act 1957 do not operate to restrict the circumstances in which the privilege can be claimed.

58 Next, I deal with the cases involving requirements to disclose an address of a client. Reference is made in paragraph 8 of the majority report to *Re Bell, Ex Parte Lees*.⁸⁵ Again, the case merely shows that the courts have circumscribed the limits of the privilege. In *Police v Mills*, Blanchard J accepted that there were four prerequisites to a successful claim that the name of a client was privileged, viz: (a) the client must have disclosed his identity in confidence; (b) the solicitor must be acting as legal advisor, not as an agent; (c) the client must not be a party in litigation; (d) either the client must be acting in the public interest or the client's identity would, in the circumstances, be incriminating information. Again, there is no legislative erosion of the privilege. The limit is a limit on the use of privilege which has been developed by the courts and which can sit comfortably with the limits to which I have already referred.⁸⁶

CONFIDENCE

59 Last year, there were reports that officials within the Inland Revenue Department had sold confidential taxpayer information. To the extent that those allegations have been proved,⁸⁷ it casts doubt on

⁸⁴ Summary Proceedings Act 1957, s 198A(2)(a); enacted on 13 March 1985 by 1985 No 55, s 2.

⁸⁵ (1980) 146 CLR 141. To be added to that is the New Zealand case of *Police v Mills* [1993] 2 NZLR 592.

⁸⁶ See para 35 above.

⁸⁷ *The New Zealand Herald*, 15 June 2000, reported on the conviction of Sopo Matagi, a former clerk at the Inland Revenue Department at Manukau City who sold debt collectors the private details of up to 850 taxpayers before she and a colleague were discovered. *The New Zealand Herald* reported that Ms Matagi “plied her illegal trade for two years and was caught only after she stole thousands of dollars’ worth of cheques from citizens trying to pay off their tax arrears”. She was sentenced to nine months imprisonment by Judge Gittos in the District Court at Auckland. She had admitted 102 charges of corruptly disclosing official information and two counts of using a document with intent to obtain a pecuniary advantage. Another clerk Ms Feterika had earlier been sentenced to 80 hours’ Community Service and a suspended term of imprisonment after admitting 19 similar charges.

the ability of the Commissioner to ensure that taxpayer information will be retained in confidence. As the Finance and Expenditure Committee noted at page 13 of its recent report:

Many submissions to the inquiry suggest that it is the manner in which the department exercises its powers rather than the extent of those powers which is at issue. . . . Voluntary compliance is a fundamental feature of the tax system. Taxpayers must believe that the tax system is fair and reasonable and that disputes will be dealt with in a fair and impartial manner.⁸⁸

- 60 The same committee referred to a decision of the Taxation Review Authority⁸⁹ in which Judge Willy had referred to a “saga of obfuscation and delay on the part of the Commissioner”.
- 61 I also place reliance on the Finance and Expenditure Committee’s report, which noted that certain actions taken by the senior management team of the Inland Revenue Department, including the Commissioner, had “engendered a culture of punishment and fear which impacts upon both staff and in turn taxpayers”.⁹⁰ The select committee went on to observe that “irrespective of the extent to which this is true, we believe that there must be a cultural shift within the department, and that shift *must* come from the top”.⁹¹
- 62 Until the public perception of the role played by the Inland Revenue Department improves markedly, it is my view that it would be inappropriate (assuming the reasons given by the majority are accepted for limiting the privilege as against the Commissioner) to restrict the privilege as against the Commissioner to litigation privilege. Thus, even if it had been demonstrated that there was a *need* to restrict the rules of legal professional privilege in relation to taxation matters, now would not be the time to effect such a change.

⁸⁸ Finance and Expenditure Committee, above n 5.

⁸⁹ *Taxation Review Authority Case 93/103 Alt cit CASE U11 (1999) 19 NZTC 9,100, 9,109*. This case was incorrectly cited in the Finance and Expenditure Committee report as TRA No.93/013.

⁹⁰ Finance and Expenditure Committee, above n 5, 51; see also *Government Response to the Report of the Finance and Expenditure Committee on the Inquiry into the Powers and Operations of the Inland Revenue Department* [2000] AJHR A.5.

⁹¹ Finance and Expenditure Committee, above n 5, 51.

EXTENT OF PRIVILEGE: THE FUTURE

63 I have indicated that it is premature to make any assessment as to the proper scope of the privilege. In my view, that assessment should be left to await developments to which I will now refer.

64 There has recently been an increased interest in the establishment of multidisciplinary practices between, in particular, lawyers and accountants. It will be recalled that the New Zealand Society of Accountants (as the Institute of Chartered Accountants of New Zealand was then known) had made representations to the Organisational Review Committee in April 1994 to extend the privilege to tax advice given by members of the Society.⁹² The issues that arise out of multidisciplinary practices are difficult and are still being considered. For example, a detailed report prepared by a committee under the Chairmanship of RS Chambers QC (as he then was) identified a number of issues in April 1999 which required more mature reflection.⁹³ As the Chambers Report noted:

The prohibition [on multidisciplinary practices] is not explicitly stated in the Law Practitioners Act 1982 . . . a number of its provisions, however, are consistent only with solicitors being able to practise only with other solicitors.⁹⁴

65 In recent times, close alliances have been publicly announced between:

- the accounting firm known as Andersen Consulting and a legal firm in Auckland called Andersen Legal;
- KPMG (chartered accountants) and Kensington Swan (a large law firm based in two major cities) – the latter is now known as KPMG Legal; and
- in a more provincial context, Beattie Rickman (chartered accountants in Hamilton) and Beattie Rickman Legal (an existing law firm which has changed its name recently).

66 These developments suggest that questions of legal professional privilege will need a further review in the context of multidisciplinary practices. In my view, it is premature to recom-

⁹² See para 38 above.

⁹³ New Zealand Law Society *Multi-Disciplinary Practices and Other Related Matters* (April 1999).

⁹⁴ New Zealand Law Society, above n 93, paras 2.3–2.4; reference is made to ss 6(1), 55(1), 84, 85, 87, 157, 171(4) and 179 of the Law Practitioners Act 1982.

mend modifications to the existing law until such time as there is more information about the structure of such firms and Parliament has decided upon a new regulatory regime for law practitioners. At that time, it will be possible to address the question whether the privilege should remain and if so, in what form. It will also be possible to address whether the class of persons from whom privileged advice can be obtained should be extended or restricted.

Paul Heath QC

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