Tax and the City Briefing for June

July 2017

Privilege

The case of *SFO v ERNC* [2017] EWHC 1017 is not a tax case (it concerned a Serious Fraud Office investigation) but the ruling is equally relevant to tax investigations and is a reminder that, in the investigations context, privilege may be available less frequently than was previously thought.

As part of an internal investigation in relation to allegations of fraud, bribery and corruption in two foreign jurisdictions, ENRC's lawyers prepared a series of documents, including interview notes, reviews of books and records and a presentation giving legal advice to the ENRC board. The High Court considered whether these documents produced by lawyers benefitted from legal advice privilege or, alternatively, litigation privilege.

Legal advice privilege

Documents can benefit from legal advice privilege if they are confidential documents shared between a client and its lawyers and they were created for the purposes of receiving legal advice. The High Court found that only the presentation by the lawyers, which the ENRC Board commissioned directly, satisfied these requirements. The court, following the Court of Appeal in the *Three Rivers* case ([2003] All ER (D) (59)) and, more recently, the High Court in *Re RBS Rights Issue Litigation* ([2016] EWHC 3161), applied a narrow view of what constitutes the client for legal advice privilege and found it only applies to communications between lawyers and individuals within the corporate entity who are authorised to obtain legal advice on the entity's behalf. It does not extend to information provided by other employees which is in turn provided to the lawyers.

Litigation privilege

It is a requirement of litigation privilege that litigation is "reasonably in prospect" and that the dominant purpose of producing the documents relates to the conduct of litigation. The High Court accepted that ENRC considered an SFO investigation to be imminent but the Court saw the information request as merely a preliminary step taken to decide whether to launch a criminal prosecution and held that criminal proceedings were not "reasonably in prospect". The same could be said of HMRC fact-finding investigations prior to civil proceedings being instigated.

The documents in the ENRC case were produced for an internal investigation, not as part of a defence to a future criminal investigation and so did not have the dominant purpose of relating to the conduct of litigation. Litigation privilege does not extend to documents giving advice on how to avoid litigation (although legal advice privilege may apply here).

In the context of HMRC investigations, this decision is a reminder to consider the purpose of any internal investigation and any documents created, as well as the recipient of any work product to ensure, where possible, that privilege applies.

Berlioz: review of legality of request for tax information

The global clampdown on tax evasion and BEPS relies on greater global transparency of tax affairs which means that it will be increasingly common, in the context of multinational groups, for tax authorities to request information from another Member State when reviewing tax affairs. It is important, however, that a balance is achieved

between sharing the information and protecting the rights of the taxpayer concerned. The recent CJEU case of *Berlioz Investment Fund* (C-682/15) is an example of this balancing act. Berlioz was the Luxembourg parent company of a French subsidiary, Cofima. The French tax authority, as part of a review of the tax affairs of Cofima, sent the Luxembourg tax authority a request for information concerning Berlioz. In response to the Luxembourg tax authority's request, Berlioz provided the information sought except for some information which Berlioz considered not foreseeably relevant to the review by the French tax authority. Consequently, the Luxembourg tax authority imposed a fine on Berlioz for its refusal to provide all the information.

Berlioz challenged the imposition of the fine but the Tribunal refused to consider whether the information order was well founded as there was no right to do so under Luxembourg law. Berlioz appealed, arguing that its right to an effective judicial remedy had been infringed. The Administrative Court of Luxembourg referred the matter to the CJEU to determine whether the Luxembourg court could examine the validity of both the information order served by the Luxembourg tax authority and the French tax authority's request for information.

The CJEU found that by imposing a fine on Berlioz for its refusal to provide information sought, the Luxembourg tax authority had implemented the EU directive on administrative cooperation in the field of taxation (the "DAC"). This triggered the Charter of Fundamental Rights of the EU and required the national court to be able to examine the legality of the information order, so it may comply with the right to an effective judicial remedy enshrined in the Charter. As stated in Recital 9 of the DAC, the information order can be lawful only if the requested information is "foreseeably relevant" for the purposes of the tax investigation in the Member State seeking it. This means that Member States are not at liberty to engage in "fishing expeditions" or to request information unlikely to be relevant to the tax affairs of the taxpayer concerned.

This decision should be borne in mind where a taxpayer receives an information notice from HMRC under FA 2008, Schedule 36 in response to an information request from another Member State because it may be easier to argue that the information is not "foreseeably relevant" than that the information is not "reasonably required" for the purposes of HMRC checking the relevant person's tax position (the test in FA 2008, Schedule 36). In the non-UK context, this case will be important in jurisdictions where there is no right to challenge an information request under domestic law as it ensures the court can nevertheless examine the validity of the information requests from other Member States and the corresponding information orders given to taxpayers.

Henderson: SDRT on redemption in specie

The exclusion from SDRT under scrutiny in this case applied at the time to a redemption in specie of units in a unit trust where the unit holder "received only such part of each description of asset in the trust property as is proportionate to, or as nearly as practicable proportionate to, the unit holder's share" (Finance Act 1999, paragraph 7 of Schedule 19). For unknown reasons (the relevant manager having since left the scheme), a unit holder received an over allocation of securities in the unit trust scheme of some 1.27% and a corresponding under allocation of cash.

In *Henderson Investment Funds Limited v HMRC* [2017] UKUT 225 (TCC), the taxpayer contended the exclusion required a "to the extent" test such that SDRT would be due on the 1.27% over allocation only. HMRC's position, however, which succeeded before the First-tier Tribunal and the Upper Tribunal, was that paragraph 7 provided an "all or nothing" or "hard edged" exclusion so SDRT was due on the market value of all the units surrendered by the unit holder. This was the result even though the relevant unit holder beneficially owned 96% of the trust's assets immediately before and after the in specie redemption.

The decision seems right on the facts – although the Tribunal and HMRC did not appear to raise the more obvious argument that there would be no need for the legislation to provide the wriggle room of "as nearly practicable proportionate too" unless the test was all or nothing. As the legislation concerned has since been repealed the case is more of interest as an example of purposive construction going against the taxpayer yet again. It was common ground that Schedule 19 should be interpreted and applied in accordance with the purposive approach set out by the House of Lords in *BMBF v Mawson* by having regard to the context and scheme of Finance Act 1999 as a whole. It is an uphill struggle for a taxpayer that, in construing a statute purposively, the court says that you cannot look at what MPs actually said in passing the legislation unless the legislation is "anomalous or illogical".

The Upper Tribunal said against the taxpayer here that "equitable principles do not apply when construing tax statutes". It would be very rare for a court now to say this against HMRC if the facts were the other way round – particularly in an anti-avoidance context.

What to look out for:

- On 21 June the European Commission will formally unveil its proposal which is expected to require tax advisers to disclose to tax authorities reportable cross-border tax planning arrangements which they have designed and for the DAC to be amended to permit this information to be exchanged between Member States from 2019. In cases where material is protected by legal professional privilege (and the tax adviser is thus prevented from disclosing the information) it is expected that the taxpayer itself would be required to disclose. The UK already has extensive disclosure rules and, soon to come, the new enablers legislation. The proposal is likely to benefit the UK, however, as it should ensure other Member States adopt similar disclosure rules to combat tax avoidance and evasion and the UK will be less out on a limb in this area (currently, it is only Ireland, Portugal and the UK which have requirements relating to the mandatory disclosure of potentially aggressive tax planning schemes).

- On 3-6 July, the Supreme Court hearing in *Littlewoods Retail Ltd* on compound interest on overpaid VAT dating back to 1973. Both the High Court and the Court of Appeal found in favour of Littlewoods that compound interest in excess of £1.2bn is the adequate remedy. Many other compound interest claims are waiting on the outcome of this one. It is no surprise, therefore, that HMRC is fighting it all the way and considers it to be "at odds with the requirements of European law and how Parliament intended VAT law to work" (Revenue and Customs Brief 9 (2015)).

- There are a couple of anti-avoidance/application of *Ramsay* cases coming up in July: on 10 July the Upper Tribunal is due to hear the appeal in the Trustees of the Morrison 2002 Maintenance Trust and others and on 17 July the Upper Tribunal is scheduled to begin hearing the appeal in *Clavis Liberty 1 LP.*

- On 18 July the Court of Appeal is scheduled to begin hearing the *Rowe and others* judicial review case on the legality of accelerated payment notices.

- Another Finance Bill, picking up the legislation omitted from FA 2017.

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