

Tax and privilege: a proposed new structure

A government discussion document

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Chapter 1

INTRODUCTION

1.1 Inland Revenue has extensive powers to obtain information under the Tax Administration Act 1994.¹ The courts have held that these powers are necessary to enable Inland Revenue to fulfil its function of ensuring that the correct amount of tax is paid and the correct tax position of every person can be ascertained. For example, 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.”²

1.2 The current legal professional privilege contained in section 20 of the Tax Administration Act 1994 protects from disclosure communications between a lawyer and a client, and is the main exception to Inland Revenue’s information-gathering powers. The current privilege has been identified in a number of reports as causing difficulties in the administration of the tax system.

1.3 This discussion document sets out a proposed new structure for the application of privilege to tax in New Zealand that would replace the current legal professional privilege applying in tax. The new rules should improve Inland Revenue’s access to factual information and, therefore, assist the enforcement of the Inland Revenue Acts. At the same time, the new rules should promote the efficient conduct of compliance with the tax laws by allowing or continuing to allow tax practitioners to have a candid relationship with their clients. The new structure would be a complete code and constitute the only legislative exception to the Inland Revenue’s information-gathering powers.

Summary of proposed changes

1.4 The new privilege structure would have two parts:

- a new privilege for opinion on tax law; and
- the existing litigation privilege based on definitions in the forthcoming new Evidence Code³ and with certain procedural rules.

¹ Inland Revenue’s primary information-gathering powers are contained in sections 16, 17 and 19 of the Tax Administration Act 1994.

² *New Zealand Stock Exchange and National Bank of New Zealand v CIR* [1992] 13 NZTC 8,147 at 8,149.

³ Legislation for which is scheduled to be introduced into Parliament in 2002.

- 1.5 The new privilege for opinion on tax law would work as follows:
- The privilege would apply only to opinion on tax law given at any time (whether before or after the filing of a tax return in respect of a tax period) by members of approved professional bodies.
 - The privilege would apply only if claimed by the taxpayer and would apply only in respect of identified documents and information.
 - If a document included both opinion on tax law and other information, the whole document would have to be provided, with any proper deletions of the material consisting solely of opinion on tax law being clearly identified in the document. The balance of any document consisting of material that was not opinion on tax law would not be privileged.
 - If Inland Revenue disputed the validity of a privilege claim, the privilege would not apply unless the claimant applied within one month for a determination by a District Court Judge of what part, if any, is privileged because it is opinion on tax law. (This would require the taxpayer to provide the unedited document to the court for review.)
- 1.6 The existing litigation privilege would continue to apply, with procedural rules similar to those applying for the privilege for opinion on tax law. The tests used in the new Evidence Code would be used for determining the boundary between what is covered by litigation privilege and what is not. The two main tests for determining this boundary are:
- The document must have come into existence when litigation is in progress or is reasonably apprehended.
 - The dominant purpose of the document's preparation must be to enable the conduct of litigation.
- 1.7 Procedural rules to ensure the physical protection of documents should also be enacted for Inland Revenue to invoke in the rare cases where it considers that there is a risk of the documents being removed, destroyed or tampered with before the validity of a privilege claim can be determined. These rules would be consistent with provisions in the Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill, which will give Inland Revenue the power to remove documents for copying.

Benefits of reform

- 1.8 A number of important benefits are expected to ensue from the reform of the privilege rules in tax.

Increasing the amount of factual information available to Inland Revenue

- 1.9 The current privilege rule prevents some factual information that is communicated between a lawyer and his or her client from being released to Inland Revenue. The new privilege structure should reduce the difficulties in tax administration caused by the current privilege by improving the department's access to factual information. Improving access to factual information will assist Inland Revenue to enforce the Inland Revenue Acts, particularly where that information will help in understanding the arrangements under investigation.

Improving competitive neutrality

- 1.10 At present, only tax advice given by lawyers is subject to legal professional privilege. However, tax advice of the same nature is frequently given by other professional advisers, such as chartered accountants. An advantage of reforming the current privilege rules is that it would remove the competitive advantage that lawyers have over other professional advisers, especially chartered accountants, in providing tax advice.

Increasing perceptions of fairness

- 1.11 If the public perceives that some taxpayers are able to conceal details of their true income and, therefore, avoid or evade payment of tax, voluntary compliance with the tax system could suffer. A decrease in voluntary compliance would increase the tax burden for those taxpayers who continue to comply with the law.
- 1.12 Reforming privilege will help to maintain the integrity of the tax system by removing such perceptions and increasing perceptions of fairness.

Promoting the efficient conduct of tax compliance

- 1.13 The new privilege for opinion on tax law should also promote the efficient conduct of compliance with the tax laws by allowing tax practitioners to have a candid relationship with their clients.

Legislative timetable and application date

- 1.14 The government proposes that amendments implementing the new tax and privilege structure should be included in a tax bill to be introduced in Parliament in early 2003, with application from the date of enactment.

Submissions

- 1.15 Submissions are invited on all aspects of the proposed new structure for tax and privilege. In particular, the government wishes to receive submissions on issues such as:

- Should the professional bodies whose members are able to give opinions on tax law that are privileged be approved by the Commissioner of Inland Revenue, or specifically listed in the tax legislation?
- Should the principles and procedures contained in Inland Revenue's 1993 policy statement on access to advice and other workpapers prepared by accountants be applied to members of other approved professional bodies such as the New Zealand Law Society?
- Should the boundary between what is covered by litigation privilege and what is not be more closely defined (in addition to using the definitions contained in the new Evidence Code)?
- Is it necessary to re-enact the existing exceptions contained in section 20(2) and (3) of the Tax Administration Act 1994 for information on trust accounts and investment receipts because such information by its very nature should not come within the proposed new tax and privilege structure in the first place?
- The proposed procedures that could be invoked on a discretionary basis by Inland Revenue to ensure the physical protection of documents for which privilege is claimed pending judicial determination of the claim's validity.

1.16 Submissions should be addressed to:

Tax and Privilege: Proposed New Structure
 The General Manager
 Policy Advice Division
 Inland Revenue Department
 PO Box 2198
 WELLINGTON

Or email: policy.webmaster@ird.govt.nz

1.17 The closing date for submissions is 31 July 2002. Submissions should contain a brief summary of their main points and recommendations.

1.18 Submissions may be published on the web site of the Policy Advice Division of Inland Revenue, in the interests of making the information widely available. Should you object to your submission being published in this way, please clearly specify this in your submission.

Chapter 2

THE CURRENT APPLICATION OF LEGAL PROFESSIONAL PRIVILEGE

2.1 The main limitation on Inland Revenue's information-gathering powers is legal professional privilege. Legal professional privilege protects from disclosure communications between a lawyer⁴ and a client and also protects from disclosure other material in the context of litigation. The rationale for the privilege is to encourage lawyers and their clients to have a candid relationship and thereby promote the efficient administration of justice.

The legislation

2.2 The protection from disclosure to Inland Revenue of communications between a lawyer and a client is contained in section 20 of the Tax Administration Act 1994. Section 20 was originally enacted in 1958 as section 16A of the Inland Revenue Department Act 1952 in response to the Court of Appeal's decision in *CIR v West-Walker*,⁵ which held that the Commissioner's information-gathering powers must be interpreted as being subject to the common law privilege applying to communications between a lawyer and a client. The purpose of section 16A was to express the *West-Walker* decision in statutory form, while preventing its application to trust accounts and other financial records.

2.3 Section 20 provides that any information or book or document is privileged from disclosure in the following circumstances:

- if it is a confidential communication passing directly or indirectly between a legal practitioner in his or her professional capacity and a client, or between legal practitioners in their professional capacity;
- if it is made for the purpose of obtaining or giving legal advice; and
- if it is not made for the purpose of committing some illegal or wrongful act.

2.4 Section 20 constitutes a code for legal professional privilege to the extent that it applies to communications between a lawyer and a client. Legal professional privilege in relation to such communications applies only to the extent permitted by the section.⁶ The section is silent, however, on the application of legal professional privilege to protect communications with third parties relating to litigation or information prepared by a taxpayer, lawyers or third parties for the purpose of litigation. Section 20 therefore does not operate as a complete code for legal professional privilege and tax because it does not cover these aspects of litigation privilege.

⁴ Here the term "lawyer" is used to mean a person who is enrolled as a barrister and solicitor of the High Court and holds a current practising certificate.

⁵ [1954] NZLR 191.

⁶ Section 20(4), Tax Administration Act 1994.

- 2.5 If anyone refuses to disclose information to Inland Revenue on the ground that it is privileged under section 20, an application can be made to a District Court Judge to determine whether the claim of privilege is valid.⁷

The courts

- 2.6 The New Zealand courts have followed the approach taken in the United Kingdom and have held that privilege applies if the dominant purpose of the communication relates to the provision of legal advice: *Guardian Royal Exchange v Stewart*.⁸
- 2.7 If documents are merely lodged with a lawyer for safe custody, they are not privileged from disclosure: *CIR v West Walker*.⁹
- 2.8 In *Leary v Federal Commissioner of Taxation*,¹⁰ a decision of the Australian Federal Court, it was held that a lawyer acting primarily in the role of a promoter of a scheme was unable to rely on legal professional privilege. Brennan J explained that:

[The] activities of an entrepreneur in the promotion of a scheme in which taxpayers would be encouraged to participate fall outside the field of professional activities; those activities are not pursued in discharge of some antecedent professional activity. Entrepreneurial activity does not attract the same privilege nor the same protection as professional activity; and the promotion of a scheme in which particular clients may be advised to participate is pregnant with the possibility of conflict of entrepreneurial interest with professional duty.¹¹

- 2.9 In *Dinsdale v CIR*,¹² the High Court held that legal professional privilege does not extend to the notes of interviews conducted with a number of third parties by auditors of a bank on instruction from the bank's solicitors. The notes were not communications between a lawyer and client, so section 20 did not apply. The Court of Appeal upheld the High Court's decision.¹³
- 2.10 In *Miller v CIR*,¹⁴ the High Court held that legal professional privilege extends to communications between salaried solicitors and their employer clients, if the solicitor is acting in his or her capacity as a legal adviser, and not in some other capacity, such as an executive capacity. The case involved discovery of legal opinions prepared by Inland Revenue solicitors. Baragwanath J applied the main Commonwealth precedent of *Alfred Crompton v Customs and Excise Commissioners (No 2)*.¹⁵

⁷ Section 20(5), Tax Administration Act 1994.

⁸ [1985] 1 NZLR 596.

⁹ [1954] NZLR 191.

¹⁰ (1980) 80 ATC 4438.

¹¹ (1980) 80 ATC 4438 at 4452.

¹² (1997) 18 NZTC 13,244.

¹³ (1998) 18 NZTC 13,583.

¹⁴ (1997) 18 NZTC 13,001.

¹⁵ [1972] 2 QB 102.

2.11 It is also well established that no privilege exists against self-incrimination in relation to the Commissioner's information-gathering powers: *Commissioners of Customs and Excise v Ingram*;¹⁶ *Singh v CIR*.¹⁷ Lord Goddard CJ stated in the former case that such privilege would "stultify the whole purpose" of the revenue's information-gathering powers.

Disadvantages of current system

2.12 The current privilege system has been identified as causing difficulties in the administration of the tax system. In particular, it allows factual information contained in legal advice given on transactions not to be disclosed to Inland Revenue, making the enforcement of the Inland Revenue Acts more difficult. This situation is inconsistent with the basic principle that Inland Revenue should have access to all factual information that is available.

2.13 In its evidence to the Davison Commission,¹⁸ Inland Revenue gave several examples of how its legitimate investigations have been hindered by privilege claims. They include:

- claiming privilege for materials held on a solicitor's file but clearly not involving matters of legal advisory nature;
- taking a restrictive interpretation of the word "control" over information held by a corporation's solicitors, when faced with a wide-ranging Inland Revenue information request;
- removing documents from files made available for inspection and not informing the department 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;
- including transaction details in the document containing legal advice to hide them from the department; and
- preventing access to offices where important records may be retained without giving sufficient notice that a claim of legal professional privilege can be made.

2.14 Voluntary compliance with the tax system could suffer if there is a perception that some taxpayers are able to use the current privilege system to conceal details of their true income, and therefore avoid or evade payment of tax. A reduction in voluntary compliance increases the tax burden for those taxpayers who continue to comply with the law.

¹⁶ [1948] 1 ALL ER 927.

¹⁷ (1996) 17 NZTC 12,471.

¹⁸ Commission of Inquiry into Certain Matters Relating to Taxation, *Report of the Winebox Enquiry*, August 1997, pp3:1:62-3:1:63.

- 2.15 Another disadvantage of the current privilege system is that it provides lawyers with a competitive advantage over other tax advisers. Privilege may be claimed for tax advice from a lawyer when advice of exactly the same nature provided by a chartered accountant is not privileged.

Support for change

- 2.16 In recent years, a number of reports relating to the application of privilege in tax have commented on the need to reconsider legal professional privilege as it applies to tax.
- 2.17 In 1994, the Inland Revenue Organisational Review Committee considered the issue of legal professional privilege. It stated that it might be appropriate to reconsider legal professional privilege generally in relation to tax matters, noting a growing trend in litigation to place “all cards on the table”.¹⁹
- 2.18 In 1997, the Commission of Inquiry into Certain Matters Relating to Taxation concluded that legal professional privilege in tax matters should be abolished.²⁰ The Commission had itself experienced considerable difficulties with privilege claims during the course of its investigations.
- 2.19 In 1998, the Committee of Experts on Tax Compliance expressed concern at the Commissioner’s legitimate investigations being hindered by dubious claims for legal professional privilege.²¹ The Committee did not make any final recommendation on the scope of the existing legal professional privilege rule applying in tax matters because it preferred the government to refer to the more detailed work on this issue which was being undertaken at the same time by the Law Commission.
- 2.20 In October 2000, the majority of the Law Commission recommended that legal professional privilege, other than litigation privilege, should not apply in tax matters.²² One of the Law Commissioners, Paul Heath QC, did not agree with this majority recommendation of the Law Commission.

¹⁹ Organisational Review Committee, *Report on the Organisational Review of the Inland Revenue Department*, April 1994, para 9.52.

²⁰ Commission of Inquiry into Certain Matters Relating to Taxation, *Report of the Winebox Enquiry*, August 1997.

²¹ *Tax Compliance: Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance*, paras 9.36-9.63, December 1998.

²² *Tax and Privilege – Legal Professional Privilege and the Commissioner of Inland Revenue’s Powers to Obtain Information*, Report 67, October 2000.

Chapter 3

A NEW STRUCTURE FOR TAX AND PRIVILEGE

- 3.1 The government proposes a new and complete code for tax and privilege to replace the current legal professional privilege contained in section 20 of the Tax Administration Act 1994.²³ The new privilege structure should reduce the difficulties in tax administration caused by the current legal professional privilege by improving Inland Revenue's access to factual information. At the same time, the new privilege structure should promote the efficient conduct of compliance with the tax laws by allowing tax practitioners to have a candid relationship with their clients.
- 3.2 Clearly, comprehensive language would have to be used to ensure that the new section 20 of the Tax Administration Act 1994 covered the field of tax and privilege and, therefore, operated as a code. Such wording could be along the following lines:
- “Despite the Evidence Code or any rule of law and except as provided in this section, no information or document is privileged from disclosure for the purposes of [the Commissioner's statutory information-gathering powers].”
- 3.3 The new and complete code for privilege and tax would consist of two parts:
- a new privilege for opinion on tax law; and
 - the existing litigation privilege based on definitions in the new Evidence Code²⁴ and with certain procedural rules.

Opinion on tax law

- 3.4 The government proposes to enact a new privilege for opinion on tax law. This new privilege should promote the efficient conduct of compliance with the law by allowing tax practitioners who give opinions on tax law to have a candid relationship with their clients.
- 3.5 The proposed privilege is consistent with the basic principle that Inland Revenue should have access to all factual information that is available. There is an important distinction between the facts of a transaction and an adviser's opinion on how the tax law applies to those transactions. It is essential that Inland Revenue has the ability to obtain all the facts so it can fulfil its function of ensuring that the correct amount of tax is paid by all taxpayers.

²³ As noted earlier, existing section 20 does not operate as a complete code for privilege and tax because it does not cover certain aspects of litigation privilege, in particular, communications between a taxpayer, or the taxpayer's lawyer, and third parties and information prepared by a taxpayer, lawyers or third parties for the purpose of litigation. Existing section 20 refers only to communications between taxpayers and their lawyers (or communications between lawyers) and section 20(4) does not prevent these other types of litigation privilege applying.

²⁴ Scheduled to be introduced in 2002.

For Inland Revenue to come to a view as to how the tax law applies to the particular facts of a taxpayer it is not necessary for it to know an adviser's view of how the law applies to their client's facts.

Main features of the proposed structure

3.6 The new privilege for opinion on tax law would work in the following way:

- The privilege would apply only to opinion on tax law given at any time (whether before or after the filing of a tax return in respect of a tax period) by members of approved professional bodies. The Commissioner of Inland Revenue would be responsible for approving a professional body. The criteria for approval would be whether the body had strong disciplinary procedures and a code of professional ethics. The main examples of such bodies would be the Institute of Chartered Accountants of New Zealand²⁵ and the New Zealand Law Society. By restricting the privilege to members of professional bodies subject to strong disciplinary and ethical measures, there is a greater likelihood of excluding persons who would abuse the privilege (despite the procedural protections).
- The privilege would apply only to opinions on tax law given by members of approved professional bodies in their professional capacity. For example, an opinion on tax law given by a director of a company who was also a chartered accountant would not be privileged if it was given by that person in his or her capacity as a company director rather than a chartered accountant. This requirement reflects the existing condition in section 20(1)(a) of the Tax Administration Act 1994.
- The privilege would apply only if claimed by the taxpayer and would apply only in respect of identified documents and information.
- If a document included both opinion on tax law and other information, the whole document would be required to be provided with any proper deletions of the material consisting solely of opinion on tax law being clearly identified in the document.²⁶ The balance of any document consisting of material that was not opinion on tax law would be treated as not being privileged. (It is only opinion on tax law that is proposed to be privileged from disclosure, not opinions generally. For example, the opinions of valuers would not be privileged from disclosure.)
- The new privilege would apply to opinion on tax law in any form, including opinions in an electronic format.
- If Inland Revenue disputed the validity of a privilege claim, the privilege would not apply unless the claimant applied within one month for a determination by a District Court Judge of what part, if any, was privileged because it is opinion on tax law. (This would require the taxpayer to provide the whole document to the court for review.)

²⁵ It is also proposed to allow privilege to apply to opinions on tax law prepared by persons enrolled as barristers and solicitors of the High Court who are employees of chartered accountants.

²⁶ This procedure would be similar to that applying to Official Information Act requests.

- The privilege would not apply to any information or document made or brought into existence for the purpose of committing an illegal or wrongful act. This is a justifiable continuation of the exception contained in existing section 20(1)(c). (This illegality exception is also a feature of other existing privileges and is included in the new Evidence Code.)
- 3.7 The requirement to particularise the documents or information in respect of which privilege is claimed should preclude the alleged practice referred to in Inland Revenue’s evidence to the Davison Commission of documents being removed from files made available to it for inspection without it being informed that privilege was being claimed for them. The proposed identification requirement is also consistent with the present procedural requirements when privilege is claimed as part of the discovery process in civil litigation proceedings. These procedural rules require parties claiming privilege to identify the documents and state the grounds for privilege by affidavit.²⁷
- 3.8 The new privilege for opinion on tax law would be a separate privilege from the existing legal professional privilege and would be akin to the separate privilege that currently exists for medical practitioners, informers, and ministers of religion. Only the litigation privilege part of the current legal professional privilege would continue to apply in tax. Lawyers, of course, would be entitled to the new privilege for opinion given on tax law.
- 3.9 It would not seem to be necessary in the case of the new privilege for opinion on tax law to reproduce the existing exceptions in section 20(2) and (3) for information on trust accounts and investment receipts because such information, by its very nature, would not qualify as opinion on tax law.

Disputing a privilege claim

- 3.10 If Inland Revenue disputed the validity of a privilege claim it would issue a formal written notice to the claimant so that the claimant was fully informed of the consequences of not initiating court proceedings.
- 3.11 The reason for placing the onus on the privilege claimant to apply for a judicial determination of the validity of a privilege claim if Inland Revenue disputes the claim, is that the department must administer the tax laws for all taxpayers, whereas taxpayers’ responsibilities are limited to their own tax affairs. Inland Revenue’s information-gathering powers could be unduly impeded if it had to initiate all court proceedings testing the validity of privilege claims, resulting in the department being unable to fulfil its function of ensuring that all taxpayers pay the correct amount of tax. Placing the obligation on privilege claimants to initiate court proceedings should also deter invalid privilege claims being made.

²⁷ The Law Commission in its *Tax and Privilege* report noted that without such a requirement to identify the documents for which privilege is claimed “it is too easy to cheat”.

Relationship with penalties

- 3.12 It would not be possible for a person to rely on privileged material as a defence in relation to the application of penalties. Someone who wanted to rely on privileged material to support the non-application of penalties would have to waive privilege and disclose the material.

Practical implications for professional bodies

- 3.13 The main beneficiaries of the new privilege for opinion on tax law would be chartered accountants working in tax, given that none of their work currently enjoys privilege from disclosure. In the case of lawyers working in tax, there would be fewer communications between lawyers and their clients that would be privileged than in the current privilege situation, under which most communications may be privileged from disclosure (with some limited exceptions such as information on trust accounts). At present, facts about a transaction that are referred to in communications between a lawyer and a client may be privileged from disclosure. Under the proposed new tax and privilege structure, no facts contained in communications between a lawyer and a client, including facts referred to in a lawyer's advice given on a transaction, will be privileged outside litigation.
- 3.14 The proposed privilege for opinion on tax law would enact aspects of the Inland Revenue's current position on access to audit workpapers (including associated management letters) and other workpapers prepared by accountants, which is set out in policy statements published in 1991 and 1993. Legislation would obviously give greater certainty than that afforded by these policy statements, so would better promote the efficient conduct of compliance with the tax laws. The principles underlying the policy statements would remain extant and, in particular, these principles would continue to provide guidance on Inland Revenue's approach to management letters associated with audit workpapers.
- 3.15 Inland Revenue would apply the principles and procedures contained in the 1993 statement entitled *Commissioner's policy on access to advice and other workpapers prepared by accountants* to material not covered by the new privilege structure that is prepared by members of approved professional bodies, including the New Zealand Law Society.
- 3.16 Inland Revenue would incorporate the principles in the 1991 and 1993 policy statements into the department's general guidelines for applying its information-gathering powers in due course.²⁸

²⁸ This incorporation would not include paragraph 5.2 of the 1993 policy statement, relating to the factual content of advice workpapers, because it is considered to be inconsistent with the basic principle that Inland Revenue should have access to all factual information that is available.

Litigation privilege

- 3.17 The existing litigation privilege would continue to apply in tax. It is generally recognised that litigation privilege promotes the efficient conduct of litigation by allowing litigants to give a candid account of their position with a lawyer without the risk of disclosure.
- 3.18 The definitions contained in the new Evidence Code would be used for determining the boundary between what is covered by litigation privilege and what is not.²⁹ The two main tests for determining this boundary are:
- the document must have come into existence when litigation is in progress or is reasonably apprehended; and
 - the dominant purpose of the document's preparation must be to enable the conduct of litigation.
- 3.19 It is envisaged that tax litigation would generally be reasonably apprehended when a person commenced to use the challenge procedures in Part VIIIA of the Tax Administration Act 1994.
- 3.20 It would not seem to be necessary to enact the existing exceptions contained in section 20(2) and (3) for information on trust accounts and investment receipts because such information should not come within the ambit of the statutory definition of litigation privilege in the first place.
- 3.21 It is worth noting that the examples given by Inland Revenue to the Davison Commission of investigations allegedly being hindered by privilege claims did not seem to involve the litigation aspects of legal professional privilege. (Instead, they mainly involved legal advice given on the tax consequences of transactions.)

Procedural requirements

- 3.22 Certain procedural requirements would also apply to litigation privilege claims. The identification of documents or information for which privilege was being claimed would be a condition of obtaining privilege. If Inland Revenue disputed the validity of a privilege claim (by issuing a formal written notice), the privilege would not apply unless the claimant applied within one month for a determination by a District Court Judge of the claim's

²⁹ The main sections relied on in the Evidence Code are sections 55 and 57. Section 57 is specifically directed at litigation privilege and provides that a person who is a party to, or contemplates on reasonable grounds becoming a party to, a proceeding has a privilege in respect of particular communications and information if the dominant purpose of making or receiving the communication or preparing the information was to prepare for the proceeding. (This definition of litigation privilege is based on tests formulated by the Court of Appeal in *Guardian Royal Exchange Assurance of New Zealand Ltd v Stuart* [1985] 1 NZLR 596.) However, section 57 caters only for communications between a party/lawyer and third parties or information prepared by the party/lawyer/third party. It does not cover communications between a party and its lawyer for the purpose of litigation because such communications are already privileged under the separate lawyer-client privilege in section 55. Therefore, for the purpose of a new section 20 of the Tax Administration Act 1994, it would be necessary to enact a form of section 57 but include lawyer-client communications relating to litigation within such a provision.

validity. (This would require the taxpayer to provide the document or information to the Court for review.)

- 3.23 A specific exclusion from litigation privilege should apply in the case of any information or document made or brought into existence for the purpose of an illegal or wrongful act. This would reflect the existing exclusion in section 20(1)(c) of the Tax Administration Act 1994.

Taxation Review Authority proceedings

- 3.24 The litigation privilege in the new section 20 should be extended beyond lawyers to communications and material involving members of professional bodies approved by Inland Revenue who are engaged in Taxation Review Authority (TRA) proceedings.³⁰ This extension is in line with the application of the proposed new privilege for opinion on tax law. The criteria for approval by Inland Revenue would, similarly, be whether the body had strong disciplinary procedures and a code of professional ethics. The main example of such a body would be the Institute of Chartered Accountants of New Zealand.
- 3.25 This extension to TRA proceedings is based on a Law Commission recommendation, although its application is narrower as the Law Commission had suggested that litigation privilege should apply in relation to any non-lawyer advocate engaged in TRA proceedings. The restriction to members of approved professional bodies subject to strong disciplinary and ethical measures would strengthen the likelihood of excluding persons who would abuse the privilege (despite the procedural protections).

Physical protection of documents

- 3.26 It would also be desirable in relation to the new code for tax and privilege to have procedures that Inland Revenue could invoke on a discretionary basis to ensure the physical protection of documents for which privilege is claimed, pending judicial determination of the claim's validity. Such procedural rules would include requiring the relevant documents to be placed in a package which is sealed and delivered to the nearest District Court Registrar for safe custody. The Committee of Experts on Tax Compliance in 1998 recommended the enactment of protective procedures along these lines. A precedent for such protective procedures is contained in section 232 of the Canadian Income Tax Act.

³⁰ Under section 16(3)(a) of the Taxation Review Authorities Act 1994, persons other than barristers and solicitors have a right of audience in proceedings before a Taxation Review Authority.

- 3.27 Inland Revenue would invoke these procedures only in rare cases where it considered there was a risk of abusive practices such as documents being removed, destroyed or tampered with. These procedural rules could apply in relation to either the new privilege for opinion on tax law or litigation privilege.
- 3.28 The procedures would be consistent with provisions in the Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill, which will allow Inland Revenue to remove documents for copying. Those provisions were also recommended by the Committee of Experts on Tax Compliance.

Application of new privilege structure to Inland Revenue

- 3.29 The new structure for tax and privilege would also apply in relation to material prepared or collected by Inland Revenue. This would not mean that information not covered by the new tax and privilege structure could not be withheld under other grounds. For example, the identity of informants would remain confidential.

How the new tax and privilege structure would work

