Know your rights … of non-disclosure

By Campbell Rose and Daniel Devcich

Some context
In February’s snap poll we asked what tax issue keeps you awake. The votes were counted, and “Inland Revenue audits or disputes” was one of the top three issues.

Budget 2012 delivered an extra $78.4 million to Inland Revenue, to further improve its tax auditing and compliance functions. The extra compliance activities were estimated to have a net positive impact on the operating balance of $354.4 million over the next four years. The context for this was a general focus by Government on “broadening the tax base, closing tax loopholes, and improving the fairness of the tax system”.

That backdrop serves as a timely reminder of the broad information-gathering powers at the disposal of the Commissioner of Inland Revenue (Commissioner). It equally serves to emphasise the importance of managing information flows effectively, so that the protection afforded to taxpayers through rights of non-disclosure can be utilised to its fullest extent.

Importance of non-disclosure rights
That protection is significant for two reasons.

First, it allows taxpayers to seek advice without the threat of that advice being used against them. This assists in promoting voluntary compliance through full and frank disclosure between taxpayers and their advisors. It facilitates a robust assessment of risk, which should form part of best practice for any sound tax governance framework.

Secondly, it goes some way to ensure that the enquiry in disputes - particularly where tax avoidance is alleged - is an objective one, not distracted by subjective motives. Inland Revenue has noted in its draft interpretation statement on the general anti-avoidance rule that the purpose or effect of an arrangement is to be determined objectively, and that a taxpayer’s intentions are not relevant; this is consistent with the Supreme Court’s judgment in Ben Nevis. However, that is not how the Commissioner makes tax avoidance arguments in the disputes process and ultimately the courts. Heavy reliance is often placed on correspondence (particularly emails) recording taxpayers’ subjective intentions and purposes. The bank conduit cases, the Alesco optional convertible note proceedings and the evidence adduced in a non-resident withholding tax avoidance hearing (Case 11/2011 (2011) 25 NZTC 1,011) are recent examples.
In practice we have seen the Inland Revenue closely scrutinise, challenge, and seek to limit or eliminate claims of non-disclosure and legal privilege. In our experience a recurring theme is that, with effective information management, the full protection of non-disclosure rights - and the attendant benefits - can be enjoyed.

**Extensive (but not unlimited) power to request information**

A logical starting point, before turning to the non-disclosure rights themselves, is the Commissioner’s general power to request information. This is contained in section 17 of the Tax Administration Act 1994 (TAA), and is exercised by the Commissioner issuing what is commonly known as a “section 17 notice”.

The power is broadly cast, requiring simply that the Commissioner consider the relevant information or documents (including electronic material) “necessary or relevant” for a tax administration, enforcement or collection-related purpose. The courts have confirmed that a “closely confined approach” is not intended, and that the power is expressed in the “widest terms”: in the *New Zealand Stock Exchange / National Bank* case, the Commissioner had requested names and details of all clients who had undertaken particular kinds of transactions – the Privy Council confirmed that this was a valid section 17 request.

That is not to say that section 17 provides the Commissioner with a limitless information-gathering power. In this context the courts have stated that the power must not be exercised beyond what is reasonably required in the circumstances (*Green v Housden*). In other words, it must be exercised for a proper purpose - which should not include accessing a taxpayer’s own tax risk assessment such as tax provision workings or a tax due diligence report, or where court proceedings are already on foot.

The Court of Appeal in *New Zealand Stock Exchange / National Bank* also observed that, in some circumstances where the Commissioner’s request necessitates the creation of new information – rather than simply providing existing information in a more appropriate and useful form – the work required of the taxpayer may call into question the validity of the section 17 notice.

In addition, the Commissioner’s own published guidance lists a number of factors that are taken into account before issuing a section 17 notice (SPS 05/08). These include the reason for requiring the information (only that which is “reasonably required in the circumstances of the case”), the impact of the request (reasonableness in relation to quantity and timeframe), previous information requests/attempts to resolve a dispute (e.g. a history of non-cooperation) and whether the information is available publicly.

All of these principles should be borne in mind when assessing and responding to an information request received from the Commissioner – whether it is a formal section 17 notice, or instead a more informal approach. Any amendments to a section 17 notice should be clearly agreed and documented with Inland Revenue, including response timeframes. This is not only for the obvious reason that non-compliance is a statutory offence, but also because non-compliance effectively allows the Commissioner to re-assess without completing a number of steps in the disputes process before an income year becomes statute barred (section 89N(1)(c)(vi) of the TAA). It is therefore prudent to treat even seemingly informal information requests as if they were section 17 notices.
Finally, we are more regularly seeing “third party” information requests issued to clients in respect of their customers. In our experience – and this is consistent with the Commissioner’s published guidance - Inland Revenue has been open to discussing and agreeing the scope of such requests, and response timeframes. This has assisted in ensuring that IT systems and human resources are adequately equipped to respond and are impacted as minimally as possible.

We understand that there is an exception to the privacy principles in the Privacy Act 1993 related to protection of the public revenue - such that disclosure of a customer’s personal information in response to a section 17 notice should not be in breach of those principles - but this should be confirmed with your usual legal advisors. You should also check what your terms of trade state in relation to the disclosure of a customer’s personal information. It is possible that disclosure will only be permitted where “required by law” (i.e. a formal section 17 notice is needed), and there may also be a requirement to notify the customer that their personal information has been so disclosed.

Non-disclosure rights - overview
There are two bases on which a taxpayer is permitted not to disclose information requested in a section 17 notice, assuming that the notice is valid. The first is legal privilege. The second is the right of non-disclosure in respect of “tax advice documents” (TAD).

Section 20 of the TAA codifies solicitor/client privilege in relation to section 17 notices. However, in our view the other categories of privilege established by common law remain applicable and protect relevant information from disclosure (for example, correspondence with offshore legal advisors). Although in practice Inland Revenue tends to initially contest this point, in our experience it is invariably conceded. We do not address this category of protection in any further detail here, but focus instead on the right of non-disclosure in respect of a TAD.
To qualify as a TAD, a document must:

a.) be confidential; and

b.) have been created:

i. by the taxpayer for the main purpose of instructing a tax advisor to advise on the operation and effect of tax laws; or

ii. by a tax advisor for the main purpose of giving advice on the operation and effect of tax laws or for recording research and analysis for the main purpose of enabling the provision of such advice; and

c.) not have been created for an unlawful purpose.

A couple of threshold issues arise out of these requirements.

First, “tax laws” means New Zealand tax laws. Therefore, advice in relation to other areas (including any advice regarding offshore taxes) is not covered.

Secondly, a “tax advisor” is a natural person who is subject to a code of conduct and disciplinary process of an “approved advisor group”. Currently the only approved advisor groups are NZICA and the Tax Agents Institute of New Zealand. Membership of NZICA is not the requirement – this means that advisors practising as principals in CA firms who are not members of NZICA, but are subject to NZICA’s code of conduct and disciplinary processes, are each a “tax advisor”.

We have outlined below other issues that have arisen in practice, in assessing whether a particular item is a TAD.

Non-disclosure rights – issues in practice

We have seen Inland Revenue challenge whether correspondence with an in-house tax manager - particularly internal emails - constitutes a TAD. Usually this has been where it is unclear in what capacity the tax manager is acting, and what the relationship is with the other party. Where a tax manager is dealing with other internal business units, we recommend it is made clear in the relevant correspondence what the function of the communication is. In other words, if the tax manager is providing (or is being requested to provide) tax advice, then that should be expressly stated.

A starting point, albeit an elementary one, is to use appropriate language in correspondence - such as stating that the tax manager’s “advice on [relevant issue] is being sought”. Where certainty of TAD protection is critical, then clarity could also be achieved through the use of appropriate templates/sign-offs etc (especially for emails). A standard footer stating that the email in question “may” be a tax advice document is not likely to be sufficient on its own, in an internal corporate context, to provide that certainty. These practices should also be adopted for communications between members of the internal tax function, where the same issues of capacity/relationship are equally relevant.
A related point is that in-house tax managers will often communicate with other parts of the business in relation to commercial, accounting and other non-tax issues. As the TAD definition requires the “main purpose” of the communication to be the provision of tax advice, care should be taken to ensure that tax advice is not intermingled with non-tax advice correspondence. We have encountered scenarios where nearly all of an email relates to (say) an accounting issue, but the final sentence contains advice on a tax issue. In those circumstances it is difficult to maintain that the main purpose of the email was to provide tax advice. If the tax advice is contained in a stand-alone email or other item of correspondence, then the issue simply does not arise.

Another illustration of the “main purpose” test causing issues is where tax advice has been summarised in (say) board minutes or a board paper. Because the test is applied to a document in its entirety, it is challenging to take the position that the main purpose of the board material was to seek or record tax advice. Instead, the summary could be provided by the tax advisor and enclosed with the board material as a separate document.

Confidentiality is also a pre-requisite for TAD treatment. As a starting point, this is usually addressed by way of appropriate footers/disclaimers in the document itself. It does however mean that great care should be taken if tax advice (whether external, or provided by an in-house tax manager) is to be disclosed to third parties. If such disclosure is necessary - for example, as part of a due diligence process - then strict protocols should be implemented in relation to the basis on which the disclosure is made, confirming that the document(s) in question remain strictly confidential. Often this will be dealt with by way of appropriate data room arrangements, obtaining written undertakings from reviewing parties to keep tax advice confidential, not copy or otherwise distribute it, and return/destroy it once the diligence process is at an end, restricting access solely to a bidder’s advisors, and so on.

Another area that has caused some uncertainty is where an email clearly recording/seeking tax advice is included in a “chain” of other emails containing material that is not eligible on its own to be a TAD. For example, other emails in the chain may include legal and accounting considerations that form part of the background to the requested advice. Inland Revenue has not published any guidance on this issue. We consider the better view is that each email in the chain should be treated as a separate “document”. On this basis, the tax advice-related email itself should qualify as a TAD assuming that the relevant requirements are met. On the other hand, it may also be possible to maintain that an entire email chain recording an ongoing dialogue or “ebb and flow” in relation to, and culminating in the provision of, tax advice, is itself a TAD.

Care should therefore be taken in email correspondence to ensure that the position is clear. This could include, for example, including background material within an email requesting tax advice rather than simply forwarding a “chain” of related emails and cross-referring to the other emails.

Concluding remarks
The non-disclosure right in respect of TADs serves an important function. That said, in our opinion there is a good case to extend the right, to cover (for example) records of tax advice such as the board minutes example outlined above; this would ensure that the policy intent underlying the right is more fully achieved.

Implementing some relatively straight-forward practices around document and information management can avoid jeopardising TAD status and ensure that the full protection of the non-disclosure right is obtained. In our experience, the area requiring greatest focus is internal emails, particularly when a transaction is on foot and communications are moving at pace towards signing or completion.

Finally, it is critical to ensure that a TAD claim is made within the prescribed timeframes – being the later of 28 days after the information request or the date for disclosure specified by the Commissioner in the section 17 notice. Where this does not occur, the right of non-disclosure will be lost. It is therefore imperative to communicate with your tax advisor as soon as a section 17 notice is received, to ensure that work commences immediately in identifying potential TADs.

For more guidance, please contact your usual Deloitte advisor.