

LITIGATION, DISPUTE RESOLUTION AND INVESTIGATIONS

Accountants' reports on tax structure not privileged

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Reports prepared by accountants on a tax structure for a company have been found by the English High Court not to be privileged, even though the company anticipated that the tax structure would be challenged by the relevant tax authorities. The Court found that the reports were not privileged as they concerned the implementation of the tax structure, not the conduct of future possible litigation.

The decision, given in [The Financial Reporting Council Ltd v Fraser Group plc \(formerly Sports Direct International plc\)](#), is a reminder that for litigation privilege to apply, a communication or document must have been prepared for the sole or dominant purpose of litigation or a regulatory investigation that is in being or reasonably in contemplation.

While the decision is not binding here, it may be of persuasive authority before the Irish courts as the test for litigation privilege in both jurisdictions is similar.

What happened in the Sports Direct case?

The UK Financial Reporting Council (FRC) requested certain documents from Sports Direct International (SDI) for the purposes of its investigation into SDI's former auditors and their conduct of an audit into SDI's 2016 financial statements.

The FRC's investigation arose from reports that SDI's subsidiary, Sportsdirect.com Retail Ltd (SDR), engaged a company to provide delivery services to SDR's customers and did not disclose its relationship with this company in the 2016 financial statements. The company was engaged as part of a tax structure adopted by SDR on the advice of its accountants in an effort to ensure that SDR paid VAT on its sales to EU customers in the UK rather than in the country of each relevant EU customer.

The FRC requested three reports prepared by SDI's accountants, and sent to its former auditors, recording the accountants' advice on this arrangement and the possible VAT implications.

SDI claimed that these documents were protected by litigation privilege and did not have to be disclosed. The key issue before the English High Court was whether these documents were prepared for the sole or dominant purpose of litigation and so privileged.

What is litigation privilege?

Litigation privilege applies to:

- confidential communications between a lawyer and a client, or between either of them and a third party;
- where the communication was for the sole or dominant purpose of litigation or a regulatory investigation; and
- at the time the communication was made, the litigation or regulatory investigation was in being or was reasonably apprehended.

If a communication or document is protected by litigation privilege, it does not have to be disclosed in the course of legal or regulatory proceedings.

The sequence of events

- **2010:** SDI's accountants devised a tax structure for SDR to enable VAT to be payable in the UK on EU sales ("the 2010 structure").
- **June 2014:** This was queried by the French tax authorities.
- **July 2014:** SDR became aware that tax authorities in EU member states were scrutinising and challenging similar structures adopted by other retailers. From this point, SDR is said to have operated on the basis that it would be involved in tax litigation in the near future.
- **July 2014:** SDR instructed lawyers and accountants to assist it in preparing to respond to a likely challenge to its VAT arrangements from the French tax authority; to minimise the risk of litigation with other tax authorities; and to put it in the strongest possible position to defend any future challenges that were made.
- **January 2015:** The accountants produced a report which set out their recommendations on a new structure and steps to mitigate the risk of challenges from EU tax authorities.
- **February 2015:** On its accountants' advice, SDR put in place a new tax structure which, it hoped, was less likely to be successfully challenged ("the 2015 structure").
- **April 2015:** The accountants produced

their second report which summarised the 2015 structure.

- **July 2015:** The accountants produced their third report which mirrored the second report but with updated figures.
- **August 2015:** The French tax authorities began a formal investigation into SDR's VAT arrangements.

Were the accountants' reports privileged?

The English High Court held that it was clear that the accountants' reports were not produced for the sole or dominant purpose of litigation, and so were not privileged. The Court accepted that when the reports were prepared, SDI expected there to be litigation over its tax structure but stated that this did not establish that the reports were written for use in that litigation. The Court stated that the expected litigation related to the 2010 structure and it was impossible to conclude that any of the three reports were directed at assisting in that litigation. The purpose of the first report was to recommend a new structure which would, it was hoped, have a better chance of withstanding challenge. Its purpose was not to enable SDR to take advice as to the merits of litigation about the

2010 structure, or to provide evidence in defence of any claim against that structure or to take advice as to how best to conduct or settle that litigation.

As to the second and third reports, they were written after the 2015 structure had been adopted for the purpose of explaining how VAT was to be accounted for under this structure. The purpose of these reports was not to assist SDR's position in future litigation, but to enable SDR to ensure that it was operating the structure as the accountants advised it should.

SDI argued that the anticipated litigation was not limited to the 2010 structure and it had worked on the basis that it was inevitable that both structures would be challenged. While the English High Court accepted that litigation challenging the effectiveness of the 2015 structure may also have been reasonably contemplated, the reports were not written for the sole or dominant purpose of the conduct of that litigation.

The Court stated:

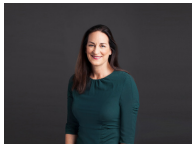
"A taxpayer who takes advice as to how to structure his affairs does not do so for litigation purposes. He does so because he wants to achieve a particular result for tax

purposes... Even if it is contemplated that the particular structure will be likely to be attacked by the relevant tax authorities and that there will be litigation, the advice as to how to implement the new structure... is not primarily advice as to the conduct of the future possible litigation. It is primarily advice as to how to pay less tax..."

Key Takeaways

1. For litigation privilege to apply, the communication or document must have been prepared for the sole or dominant purpose of litigation or a regulatory investigation that was in being or reasonably contemplated.
2. Even where it is contemplated that a particular tax structure may be challenged, advice on how to implement the structure of itself (as distinct from advice on the conduct of any potential litigation in relation to the tax structure) is not protected by litigation privilege and may be discoverable.
3. However, where that advice is legal advice given by lawyers to their client, it may be protected by legal advice privilege, a separate strand of privilege.

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