# US Discovery In The UK — The Tax Context

Law360, New York (November 21, 2013, 8:18 PM ET) -- Cross-border business structures are coming under increasing and intense scrutiny, especially in relation to the structure and management of their tax affairs. In conducting reviews of a U.S. taxpayer's affairs, or as part of proceeding to litigation, the Internal Revenue Service may want access to information that is located outside the U.S. In this article, we look at how the IRS can obtain U.K.-located information that is relevant to a U.S. taxpayer.

## The Tax Treaty and OECD Convention

The U.S./U.K. Double Tax Treaty and the Organization for Economic Cooperation and Development Convention on Mutual Administrative Assistance in Tax Matters provide the two principal methods by which the IRS can obtain information located in the U.K.:

- Under Article 27 of the Double Tax Treaty, the U.S. can require the U.K. to collect and provide information relating to the U.S. taxpayer's affairs. The relevant tax must be one which is covered by the Tax Treaty — taxes covered are federal income taxes (excluding social security taxes) and certain federal excise taxes. The U.K. is then obliged to use the procedures available to it, discussed further below, in order to collect the information as if the U.S. tax was U.K. tax. There are, however, limitations on the U.K.'s obligations. In assisting the U.S., the U.K. is not obliged to carry out any procedure that is contrary to U.K. or U.S. law and administrative practice, nor is it obliged to obtain information which is not obtainable under U.K. or U.S. law or administrative practice, which might disclose trade, business, industrial, commercial, or professional secrets or trade processes, or would contravene public policy if disclosed.

- Articles 4 and 5 of the OECD Convention on Mutual Administrative Assistance in Tax Matters allow the U.S. to require that the U.K. provides information that is "foreseeably relevant" to the collection, recovery and enforcement of certain U.S. taxes. The related tax must be one which is covered by the OECD Convention, although the range of covered taxes is broad. Information that is "unlikely to be relevant" does not have to be provided. Similar limitations to those under the Tax Treaty concerning procedures which contradict U.K. or U.S. law, or information which would disclose trade secrets or offend public policy, apply to the U.K.'s obligations under the OECD Convention. In addition, the U.K. can refuse to: (a) provide information if the U.S. has not pursued all domestic means available; (b) carry out measures which it considers are contrary to its essential interests; (c) provide administrative assistance if and insofar as it considers that the taxation in the applicant state is contrary to generally accepted taxation principles or to the Tax Treaty; and (d) offer assistance if the application of the OECD Convention would lead to discrimination between a national of the U.S. and nationals of the U.K. in the same circumstances.

## Procedures Available to the U.K. — Notice Under the Finance

## Act 2008

### *Issue of a Notice*

Once a request has been made by the U.S. under either the Tax Treaty or the OECD Convention, the U.K. must then seek to obtain the necessary information in accordance with U.K. law. This is done by the U.K. tax authority, "Her Majesty's Revenue & Customs" (HMRC) .

The main procedure available to the U.K. to comply with such U.S. requests is for HMRC to issue a notice requiring the production of information under Schedule 36 of the Finance Act 2008. Such information must be "reasonably required" for the purpose of checking the "tax position" of another person. "Tax position" is interpreted widely and can include U.S. tax, although "reasonably required" is a key limitation that is described further below. A notice must specify the time within which the information must be provided and although there is no minimum period, that period must be reasonable.

Where the U.S. taxpayer has a U.K. presence, such as a branch, the notice can be issued to the taxpayer. HMRC can issue a taxpayer notice either with or without the consent of the "First-Tier Tribunal," a specialist judicial body which decides on a number of matters, including those concerning tax.

A notice can also be issued to a third party, such as an adviser to the U.S. taxpayer concerned. However, HMRC can only issue a third-party notice if the U.S. taxpayer concerned consents, failing which the consent of the First Tier Tribunal must be obtained.

For both taxpayer and third-party notices, the obtaining of Tribunal consent will impact the ability of the recipient to appeal the notice (see below).

### *Tribunal Consent*

Where HMRC seeks Tribunal consent for the issue of a notice, the key condition for the Tribunal to consider is whether the Tribunal is satisfied that, in the circumstances, the particular HMRC officer who gives the notice is "justified" in doing so. The other conditions — which the Tribunal can waive where it is satisfied that HMRC has reasonable grounds for believing that the assessment or collection of tax would be otherwise prejudiced by doing so — are that the:

- Intended recipient of the notice (be it U.S. taxpayer or third party) must be told that the information is required and must be given a reasonable opportunity to make representations to HMRC;
- Tribunal must be given a summary of those representations; and
- U.S. taxpayer must be given a summary of the reasons why the documents are being requested (third-party notice only).

### *Appeal Against a Notice*

The key impact of HMRC obtaining Tribunal consent for the issue of either a taxpayer or third-party notice is the recipient's ability to appeal the notice.

Generally, and save for the ability to seek "judicial review" of a notice (discussed further below), the U.S. taxpayer cannot appeal a taxpayer notice that is issued with

Tribunal consent. Where a taxpayer notice is issued without Tribunal consent, the U.S. taxpayer may appeal in writing within 30 days of the notice being given.

Similarly, and subject to the ability to seek judicial review of a notice, a third party cannot appeal a third-party notice that is issued with Tribunal consent. Where a third-party notice is issued without Tribunal consent, but with the U.S. taxpayer's consent, the third party's appeal rights are restricted to appealing on the grounds that it would be unduly onerous to comply with the notice.

In all instances, whether a notice is issued with Tribunal consent or not, a recipient may seek what is called "judicial review" of the issuance of the notice. Judicial review is a process which ensures that bodies exercising public functions observe substantive principles of public law and adopt a decision-making process which is lawful. An application for judicial review must be made promptly and, in any event, generally not later than three months after the grounds for bringing the claim first arose. The procedure can be a costly one.

If a recipient is of the view that a notice has been issued in breach of any procedural requirements, then the recipient may have grounds for arguing that the notice is invalid, although any such arguments will generally have to be raised in the above-mentioned appeal processes.

## The Limits of a Notice

There are a number of limitations that apply to filter the information that has to be disclosed in response to a notice. There are seven particular safeguards which are generally of most relevance and interest. These are as follows:

*1. "Reasonably required"* — the information must be "reasonably required" for the purposes of checking the U.S. taxpayer's U.S. tax position. The concept of "reasonably required" is somewhat vague and subjective.

HMRC's published view is that "reasonably required" means getting the balance right between the burden put on someone to provide the information, and how important the information is in deciding on the correct tax position. Crucially, however, HMRC's view is that tax advice received from a tax adviser is not usually something that is reasonably required to check the taxpayer's tax position. This is because advice generally relates to why a particular tax position was taken, rather than how a particular tax position was achieved.

This is a key safeguard as it can operate to filter out advice that the U.S. taxpayer has obtained and which is held by the recipient.

*2. Legal professional privilege* — the recipient is not obliged to produce information in respect of which a claim to legal professional privilege could be maintained. In England, legal professional privilege is broadly divided into legal advice privilege (akin to attorney-client privilege in the U.S.) and litigation privilege (akin to work-product privilege in the U.S.). There exists a dispute resolution mechanism where there is a disagreement as to whether information is privileged or not.

*3. Tax adviser "privilege"* — a third party is not obliged to produce information in response to a third-party notice where, at the applicable time, it had been appointed to give advice on the tax affairs of the U.S. taxpayer and the information consists of communications between it and the U.S. taxpayer (or another tax adviser of the U.S. taxpayer) the purpose of which was the giving or obtaining of advice about any of those affairs.

The third party can rely on this safeguard as long as the communication concerned is between it and the U.S. taxpayer, and has the purpose of giving or obtaining advice about the U.S. taxpayer's tax affairs. It should not matter if another person is copied into the communication, although that other person may not be able to rely on this

safeguard if they received a notice.

The above said, a third party can only invoke this safeguard in relation to documents that belong to it. If the document belongs to the U.S. taxpayer or another party, this safeguard will not apply — although where that document contains tax advice it can be argued that such advice is not reasonably required to check the U.S. taxpayer's U.S. tax position. Terms of engagement between the third party and the U.S. taxpayer should therefore be checked to see which party is treated as owning work specified in the engagement, as if the work becomes the property of the U.S. taxpayer, the third party may be unable to invoke this safeguard.

In addition, this safeguard can be overridden where the third party has assisted the U.S. taxpayer in the preparation or delivery of accounts, returns or other documents sent to HMRC and the requested information (or document containing the information) explains the accounts, returns or other information or documents given to HMRC.

*4. U.S. discovery rules apply* — both the Tax Treaty and the OECD Convention provisions apply a further filter that effectively applies U.S. discovery rules to HMRC's ability to obtain information.

*5. Information relating to the conduct of a pending appeal* — the recipient is not obliged to produce information that has been brought into existence as part of the preparation for the presentation of a tax appeal.

*6. Document in person's possession or power* — the recipient is not obliged to produce a document unless it has physical control over the document (no matter who it belongs to) or it has the ability to obtain the document, or a copy of it, from whoever holds it.

*7. Documents more than six years old* — the recipient is not obliged to produce a document the whole of which is more than six years old, although this requirement can be disapplied with the agreement of an authorized officer of HMRC.

## Alternative Approach?

Prior to the issue of a notice, HMRC will typically inform the intended recipient that an information request has been received from the U.S. under either the Tax Treaty or the OECD Convention, and seek the informal production of information without the need for a notice.

This informal procedure is advantageous when compared with the operation of a notice, for a number of reasons. The clearest advantage is that is opens a dialogue between the recipient and HMRC. By adopting such a process the recipient and HMRC may agree to the provision of information that would be provided in response to a notice, in an environment that gives the Recipient much more control and input than it would have in the formal notice procedure. This is especially the case with a third-party notice where once the notice is issued, absent an expensive judicial review procedure, there either exists no, or a very limited, ability for the third party to appeal, and the U.S. taxpayer has no input. Another possible advantage of the informal procedure is that HMRC may seek to use any information provided for its own purposes, e.g. in an action against a third party (although it is not entirely clear whether HMRC can do so). If there is any concern, the recipient may seek to use the informal procedure to provide information direct to the IRS.

While this flexible approach should be less costly and time consuming, if there is any continuing disagreement between HMRC and the recipient over whether a particular piece of information should be provided, HMRC can still go ahead and issue a notice. The effect of this will be to extend the cost and timeframe of the exercise overall.

A third party may also be unwilling to follow an informal process due to concerns regarding possible breaches of data privacy rules which it is bound by.

## Conclusion

In large or complex cases, a great deal of information can be subject to a notice. Where practicable, it is always worth exploring an informal disclosure approach with HMRC so that a practical approach may be adopted.

Whichever process is followed, the safeguards that restrict the scope of disclosure are paramount, and advisers must have a clear understanding of those safeguards to ensure that the right information is disclosed.

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[1] References in this article to "U.K. law" are to the laws operating within the U.K. As a general matter, tax law applies across the U.K., but other laws, such as administrative laws, can be different in England & Wales and in Scotland, which are generally subject to different legal systems.

[2] In addition to the exchange of information by request, the OECD Convention also provides for the automatic and spontaneous exchange of information in particular circumstances, included where the information is "foreseeably relevant" to the collection, recovery and enforcement of taxes, or if one party to the OECD Convention has grounds for supposing that there may be a loss of tax in another party to the Treaty (Articles 6 and 7).

[3] The applicable rules refer to "documents" as well as "information." In this article, where we refer to "information" we are generally referring to documents as well. HMRC also has broad powers to obtain data relating to items such as employment-related payments, interest, dividends, rents and payment card transactions. These powers are not addressed in this article.

[4] The appeal must be made in writing, within 30 days of the Notice being given.

[5] Our comments on judicial review apply to judicial review as it applies in England & Wales, although we understand there is a judicial review process in Scotland.

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