- Can a strict duty of confidentiality for lawyers harm the global market?
- What is the rationale for the strict duty of confidentiality?
- What should be safeguarded? What should not be safeguarded?
- Does a strict duty of confidentiality stand in the way of human rights?

APRIL 2013 pwyp.no

Silence is golden

Published by: Publish What You Pay Norway
Year of publication: 2013
Place of publication: Oslo, Norway
ISBN 978-82-93212-07-2

Contributing authors: Morten Eriksen, Daniel Reeves, Guttorm Schjelderup, Tim Daniel, Antonio Suarez-Martinez, Henry Stewart and J. Christopher Jensen*.
Cover illustration: Roar Hagen
Translations of articles: Knut Engedal
Print: CopyCat

Published with financial support from Norad.

Many thanks to all the contributors!

Legal disclaimer:

This publication is based on information provided to Publish What You Pay Norway ('PWYP Norway') and individuals acting on behalf of PWYP Norway. The conclusions presented herein are based only on information so provided. PWYP Norway and those acting on behalf of PWYP Norway have strived towards acquiring full overview of all relevant information and data to prepare this publication. We do not accept liability whatsoever for any insufficiency or inadequacy of the information and data that this publication is based upon.

While PWYP Norway has taken all reasonable care to ensure that the information contained in this publication is accurate, publicly available information and data has not been verified by the companies or users and neither PWYP Norway nor any person acting on behalf of PWYP Norway in the drafting and preparation of this publication can be held legally responsible for the content or guarantee that it is totally free from errors or inaccuracies.

Any references contained in this publication pertaining to any kind of sources, publications or websites from third parties, are inserted for convenience only and are purely for informative purposes. They do not constitute endorsement of material on those sites, publications or sources. PWYP Norway and those acting on its behalf accept no liability whatsoever for any loss or damage arising from the use of such information.

* International Senior Lawyers Project

Content

Preface ... 4

Will lawyers ruin law? ... 6

Financial Secrecy, Tax Evasion and the Financial Community that Facilitates and Enables Them ... 12

Form and substance: Multinational corporations and tax planning ... 16

Legal Professional Privilege: England and Wales ... 25

A lawyer's obligation to safeguard confidential client information under U.S. law ... 30

Preface

Both here at home and internationally it is being discussed if multinational companies really should not pay tax. Has tax become a "voluntary thing" for the multinationals? Multinational companies can, with the assistance of professional tax advisors with a deep knowledge of the distinction between different countries' tax systems, pursue advanced tax planning across national borders. Central to this is the establishment of, and intensive use of, subsidiaries, incorrect pricing, establishing companies with a high proportion of loans, often combined with the use of hedging and derivatives, and not least the intensive use of tax havens. These tax havens offer secrecy when it comes to ownership, activities and shell companies. Profit is being shifted to jurisdictions with secrecy and no or low tax is paid and company expenses are recognized to the jurisdiction where the companies can write off the costs.

In this way multinational companies can access deductions and depreciation in the country where they operate. At the same time they can make creative maneuvers to avoid getting into a position where they would have to pay tax, when the moment for paying the company's tax liabilities arrives.

To plan and facilitate that companies do not pay tax has become a global and lucrative business.

Lawyers have a duty of confidentiality. The confidentiality springs from "the best interest of society" and lawyers shall safeguard rule of law in the society. However, confidentiality also has a different and unintended effect that it is necessary to shed light on.

Companies can claim client confidentiality to protect themselves against government insight into activities and transactions, transaction routes and company structures. The lawyers can also claim client confidentiality to prevent insight into to what they have participated in.

In the report "Piping Profits", we exposed that ten of the leading companies within the oil, gas and mining sector in the world, use at least 6038 subsidiaries, and that more than one third of these subsidiaries are located in tax havens.

Today 60 % of all trade in the world takes place within a company's own structure. More than one third of the GDP in the world is passed through tax havens. One third of the global GDP is kept in tax havens. The global financial integration has developed much faster than the various national governments' capacity to get an overview and insight into which implications this has for the nation's laws and economy, and in particular its legislation.

Poor countries with non-renewable and finite natural resources, such as oil and minerals, are in a particularly vulnerable position. In Africa the estimated value of oil exports alone is approximately nine times the value of all international aid in total. Over the decades, it generated enormous assets, but these assets end up other places than Africa. Capital that should accrue to developing countries or the home country, is moved within a company structure and transferred to tax havens.

Developing countries are being drained of nearly 1000 billion US dollars each year. That equals ten times as much as the value of total international aid to poor countries. Tax evasion from commercial companies constitutes the largest share of illicit financial flows.

Publish What You Pay Norway (PWYP Norway) is an organization that is very concerned with the general conditions of the individual, the protection of freedom of expression, the protection of human rights and transparency in society. We believe that there is no contradiction in seeking to protect the lawyer's duty of confidentiality, on one hand (a high priority for PWYP Norway), and at the same time ensuring that confidentiality cannot be misused. (also an issue of the highest priorityfor PWYP Norway.) To comply with and protect the privilege of confidentiality, it is therefore essential to clarify that confidentiality is a means to defend a client, not to be jointly responsible for tax evasion. The latter would be a clear abuse of confidentiality that would undermine the privilege of confidentiality.

These days, important questions regarding the extent of lawyers' privilege of confidentiality in the tax area are being asked. PWYP Norway presents a small selection of short articles that highlight various aspects of this issue.

For more information on PWYP Norway's positions, please, see www.pwyp.no

Mona Thowsen
Secretary General
PWYP Norway

Will lawyers ruin law?

By Morten Eriksen, Senior Public Prosecutor

The article was first published in Norwegian, in *Skatterett* 3/2012.
Full version of the Norwegian article is available on www.idunn.no.

1. Legal fiction industry – a growing market

The important and noble role of law and lawyers is to create predictability, certainty, clarity and justice between people, between businesses, and in society in general. The available tools are public law regulations and private law instruments like agreements, corporate structures and transactions, which come in many varieties. Any unresolved issues need to be interpreted loyally within the scope of the wording, objectives and legislative history of applicable statutes.

But the same private law instruments may also be used to conceal underlying realities; to mislead, create ambiguity and uncertainty, and conjure up a chimera of reality. Some lawyers seem more concerned with how to circumvent the legislation or make arrangements on the basis of what can be proved if such circumventions are detected, rather than with complying with the legislation in accordance with the intentions of the lawmakers.

A global and growing legal fiction industry seeks to develop products that use law to obscure a fictitious fact, with third parties being denied access to further details.

A global and growing legal fiction industry seeks to develop products that use law to obscure a fictitious fact, with third parties being denied access to further details. A fictitious fact provides a description of reality that deviates, in full or in part, from underlying realities. Such part of the facts as is disclosed externally, for example to creditors or tax authorities, is not necessarily incorrect when taken in isolation, although it is in most cases incomplete. However, such information as is disclosed conveys a highly misleading impression of the realities of the overall transaction, activity or corporate structure. This should make most lawyers realise what they are getting themselves into.

It is seemingly fascinating that fictitious legal exercises can be used to eliminate the law and operate in secret where one lives or engages in economic activity, or to unrestrictedly reassign costs and benefits between various legal entities controlled by oneself in different countries. In formal terms, one can by using simple legal instruments do anything, at any given time, and be «domiciled» anywhere – irrespective of the underlying realities. One can get rid of obligations and burdens whenever desirable, whilst at the same time retaining rights and benefits, which is always desirable.

It is necessary to have rights where economic activities are pursued. One cannot physically relocate oil fields, mineral deposits or markets. The rights give access to the value added in markets with spending power, to commercial activities or to natural resources (e.g. oil and minerals), as well as to public and private goods. This creates welfare and security where one lives, finds work or runs one's business.

It is, at the same time, tempting to get rid of the obligations, or rather the basis for the obligations, i.e. to reduce taxable income or expand income-reducing costs. By using simple legal mechanisms, profits can be shifted from the state of residency or the state of origin, where the economic activity takes place, to states where there are no significant «obligations», and where nothing much happens either.

Translated by Knut Engedal. Norwegian original title: "Vil jurister ødelegge jussen?".

2. Too good to be true?

In theory, it should not be that simple, but this is where legal advisers, secrecy, fictions and formalities enter the picture.

It is a main prerequisite for success that authorities, investors, public and private creditors and others suffering the harmful effects are unable to uncover the underlying realities. In order to remove the basis for obligations in the state of origin, it is necessary to cut the visible links between such basis and one or more control points; who one is, what is actually going on, where one is in fact running one's operations, or what one actually owes, owns and earns. This requires effective concealment opportunities.

Whilst Norway and most developed states premised on the rule on law enact legislation that predominately regulates matters within their own jurisdictions, about 1/3 of the world's states offer secrecy mechanisms, corporate structures, banks, post office boxes and computer capacity specifically designed to conceal what takes place in other states – provided, however, that the harmful effects are only suffered there. This is not the exercise of national sovereignty, but deep and unacceptable interference in that of others.

Complete secrecy is not always necessary. On the contrary – the intention may well be to display externally what jurisdiction one apparently operates from, whilst at the same time presenting misleading snapshots or fragments from a series of transactions between companies one controls in various states. When taken in isolation, the disclosed information is not directly wrong, but it conveys a highly misleading or incorrect overall impression. One may for example inform the outside world about a front company, or the first step in the transaction, which triggers benefits (rights) where the income-generating activities are pursued, whilst subsequent or underlying steps that reveal the realities are concealed.

It is easy to redirect income from the state of origin, where the economic activity takes place, through internal transactions in complex onshore and offshore multinational corporate structures, to states where nothing at all
<?>of significance happens, but where taxes, creditors and various regulations can be avoided. The technicalities involved are, amongst other things, artificial costs, manipulated transfer prices, thin capitalisation, misuse of derivatives, impenetrable merry-go-round transactions, exploitation of weak financial reporting rules, abuse of the strict confidentiality obligations of lawyers, etc.

The implication of these formalistic exercises is that costs are high, whilst profits are nil or low, in companies in the states of origin – where the economic activity is taking place. This is mirrored by high profits and low costs in the tax havens, where there is no tax liability or bothersome creditors, and where most of the time no significant value is added. That does not make sense.

The number of states offering structures that are tailor-made for undermining legal relations in other states has increased considerably over the last 30–40 years. The same applies to the subtlety of the range of obfuscating corporate and trust structures on offer. Access to new products is driven by a rapidly growing global market with a high demand for secrecy and concealment opportunities.

The figures indicating the volume of «activities» in tax havens are explosive. There are more than 800,000 companies in the British Virgin Islands alone, with a population of about 19,000 people. Relative to population, this would correspond to about 170 million limited liability companies in Norway. We have somewhat in excess of 270,000. Ten of the largest multinational extraction companies have about 6,000 subsidiaries worldwide. About 2,000 of these are registered in tax havens, where in most cases hardly anything at all happens.

It is assumed that between NOK 130,000 and 200,000 billion is invested in the several million secret bank accounts, companies, trusts and other structures found in tax havens.

It is a main prerequisite for success that authorities, investors, public and private creditors and others suffering the harmful effects are unable to uncover the underlying realities.

Aggregated figures from the UBS scandals showed that about 95% of 55,000 US taxpayers holding investments in Switzerland did not report these to the tax authorities in the US.

No data are available for other assets than liquid investments in banks, since the tax havens have no meaningful form of financial reporting or registration obligations. Concealment is not only offered in tax havens. Switzerland, Luxemburg and the US (Delaware) are frequently used for concealment purposes, although they are in some respects different from classic tax havens.

About half of global cross-border transactions are channelled via tax havens, despite no significant economic activity taking place there in the vast majority of cases. On the contrary – local legislation require the activities of so-called «foreign companies» to be pursued in other states. Provided that the activities take place in other states, one is granted «freedoms»; i.e. no financial reporting obligations, document storage obligations, taxes or other obligations that apply
<?>to business activities in civilised societies. Local trusts and companies can be moved swiftly and with minimal formalities to other jurisdictions if anyone seeks to find out who is behind them. After all, such relocation has no local implications.

Remarkably enough, it is at the same time expected that the states suffering the harmful effects shall accept companies registered in tax havens as bona fide legal entities, as if their economic activities were pursued there.

Developing countries suffer the most. The rich countries take 10 dollars back for every dollar of development aid granted. Paradoxically enough, developing countries with major natural resources often experience weaker economic development upon the commencement of resource extraction (the «resource curse»). Dishonest heads of state contribute to the diversion of large parts of the value added, through large-scale corruption and mismanagement. Tax havens are instrumental in concealing such diversion of funds. Studies carried out by the Norwegian Agency for Development Cooperation (Norad) uncovered that only 3–5% of export value from the production of multinational mining companies holding extraction licenses in Zambia accrued to the host country.

> It is paradoxical that multinational companies benefit from human rights preventing access to information that are much more effective than the human rights of the poorest in the poor countries to access to information from the extraction industry...

Because tax havens require no disclosure, the cost elements in goods, «services» and «intellectual property» may be conjured out of nothing, but still give rise to deductibility in states where the economic activity takes place. Companies based in tax havens may invoice unverifiable «costs» to associated onshore companies for leasing operating assets, purchasing financial services, knowhow, branding, management services, distribution networks or insurance services – despite little or no local activity. No authority in any state anywhere is able, due to the secrecy mechanisms, to penetrate the entire range of multinational concealment techniques.

As if that was not enough, legal safeguards offer much better protection for established positions, and for those who make unlawful adaptations («possession is 90 % of the law»), than for those who are the victims of these. For this reason, amongst others, human rights have paradoxically enough (unintentionally) become a negative factor that contributes to the continuation of the harmful diversion of natural resources in developing countries.

It is paradoxical that multinational companies benefit from human rights preventing access to information that are much more effective than the human rights of the poorest in the poor countries to access to information from the extraction industry, or to the repatriation of funds that have been stolen from them. Developing countries are thereby deprived of access to information that might ensure that they get a fair share of the value added from valuable natural resources – which is in most cases their only source of welfare improvement.

Human rights are acclaimed on a virtually continuous basis. Often for the best of reasons. Everyone has human rights – at least in theory, although not in practise. Because of

profound imbalances in terms of effective access to rights, human rights may turn into a harmful rhetorical tool that hurts the poor, who have in practise no rights.

It is unlikely that many people believe that it ought to be like that, but this is what happens when the development of rights takes place in the North, through case law that is not readily accessible, and within a very resource-intensive legal system. Supranational courts perform only limited assessments of wider impacts, despite having in some respects been given very wide-ranging political mandates, like the four freedoms under EU law, and broad legal standards in the European Convention on Human Rights of 1950. What was intended as our ultimate system of norms for important protection needs has turned out not to be so for many people. Besides, human rights are procedurally and substantively so complex, intricate and unpredictable as to often have an alienating effect on those who are most in need of protection, whilst allowing good scope for legal challenges for those who have the least need for such rights, and who already command the most resources.

It is all completely legal, goes the argument. Maybe so – at least in those states where the harmful effects are concealed, but not necessarily where they occur.

It is all completely legal, goes the argument. Maybe so – at least in those states where the harmful effects are concealed, but not necessarily where they occur.

3. Clever?

Some take the view that this is simply clever adaptation to the opportunities on offer. However, the secrecy in the confidentiality jurisdictions also contributes to the promotion of a number of forms of serious crime. Although tax planning may have been the most important driver behind the development of the tax haven structures, there are also many who abuse the system for criminal activities once the structures are in place. The documentation is massive and overwhelming.

At present, closed tax havens are without a doubt the largest money laundering centres in the world. What many advisors are not aware of is that the money laundering provision in Section 317 of the Penal Code, which is based on international obligations, is comprehensive in scope. The money laundering actions to which it applies are multifarious, and may be committed prior to, during or subsequent to the primary offence. Moreover, the group of persons falling within its scope is very broad, and ordinary negligence is sufficient for a conviction. This implies that it does not take much to become guilty of aiding and abetting money laundering when assisting in the abuse of tax haven structures. Assistance in the form of establishing bank accounts in tax havens may, for example, result in criminal liability, provided that the conditions are otherwise met. One should, at the very least, be reasonably certain that the account is not involved in any money laundering scheme.

There are those who defend the activities of tax havens. Foreign co-investors are allegedly demanding that the investments shall be made from tax havens. In such
<?>case one needs to ask oneself why co-investors demand that investments be made from secretive tax havens, where hardly anything at all happens. One should in such cases ensure that one is not aiding and abetting tax fraud in other states, which may also represent a violation of Section 317 of the Penal Code.

Another argument is that banks in developing countries are not secure or experienced enough to offer acceptable asset management. That may be true, but is still no weighty argument. A number of banks in developing countries are not insecure at all. Nor are the tax havens a sound alternative, since they do not offer expertise or security to match those of sophisticated onshore financial centres. If a secure framework is required for, say, a development fund, Norwegian politicians are certain to accept tax exemptions for funds registered in Norway, or the distribution of untaxed amounts to developing countries without deductions. At least if the alternative is to invest Norwegian tax proceeds in developing countries through developments funds based in tax havens, as does Norfund.

Government bodies, journalists, NGOs, prosecuting authorities and others seeking to combat large-scale crime often suffer gross harassment, ruinous litigation, dismissal, threats, violence and in some cases assassination.

It has been convincingly documented how tax havens undermine the scope for poverty eradication and the development of democratic societies. Tax havens contribute to unacceptable distribution effects, they considerably reduce the scope for healthy competition, and they hold back welfare developments in the states where economic activity is taking place.

No global financial crisis is unaffected by the fiction industry, which exacerbates such crisis and assists those who wish to register themselves away from crisis countermeasures. And no macroeconomic governance models can correct for the effects of transactional fictions.

Imagination is the only limit within the world of legal fictions. Supranational countermeasures are often too slow and ineffective in the face of global abuse of the law. States based on the rule of law work best with stable societies, under simple and clear circumstances, where straightforward legal instruments can be used, within jurisdictions where there is agreement about basic values – provided that one has the resources necessary to make use of the judicial system. Very few have the latter, thus again increasing the profitability of the extraction industry, to the detriment of developing countries. The courts of law are not used to making broad-based global assessments when resolving disputes, although the wording of international conventions provides them with virtual carte blanche discretion to do so.

The fiction industry represents what is possibly the main legal challenge the world is facing. It is enormous in scale, harms legal systems, contributes to the large-scale development of most forms of crime, as well as the accumulation of capital on ever fewer hands. It is hard to defeat, and difficult to debate, because the activities are confidential and conceal the abuse of legal instruments that are intended for other positive purposes. Such abuse is often rhetorically cloaked in positive words like due process, exercise of sovereignty, «flexible solutions», commercial necessity, privacy or free competition – although these characteristics are in most cases totally inappropriate.

The global market cannot be premised on legal structures that allow anyone to undermine the efforts of nation states to create well-functioning societies.

Uncovering even serious crime is difficult, exactly because of the secrecy. And again it is developing countries that are worst affected and most vulnerable. Heads of state, prominent politicians and government officials misuse tax havens to conceal large-scale corruption and tax fraud. The road to detection and exposure is in most cases much too convoluted. Government bodies, journalists, NGOs, prosecuting authorities and others seeking to combat large-scale crime often suffer gross harassment, ruinous litigation, dismissal, threats, violence and in some cases assassination. This affects the recruitment and commitment of those following in their footsteps, and thus the scope for effecting change for the better.

Global problems require global solutions. Lawyers have probably never before been as influential as they are now. Not least because of globalisation. This provides opportunities for abuse of power, if one is reasonably certain of not being found out. Which poses considerable challenges for lawmakers, enforcement authorities and the courts. It is not easy to accept that a number of states can offer legal structures that serve exclusively to undermine legal relations in other states. Lawyers need to become positive drivers for improvement, instead of contributing to the problem.

Financial Secrecy, Tax Evasion and the Financial Community that Facilitates and Enables Them

By Daniel Reeves
Senior Advisor, Offshore (Retired),
United States Internal Revenue Service

Introduction

Financial secrecy and offshore tax evasion have become very big business. What was once thought of as the sole and exclusive provenance of the very wealthy, the elite and the privileged has grown exponentially in recent years into a major financial industry throughout the world. Financial secrecy services that once were available only within exclusive private banks located in financial centers such as Switzerland, Monaco and Lichtenstein can now be found in more than 80 secrecy jurisdictions around the world that, according to some estimates, hold as much as 32 trillion U.S. dollars in unreported wealth.[1] Various estimates have put the amount of taxes lost to the United States alone at between 40 billion and 100 billion U.S. dollars per year.

The notion of hiding money offshore to avoid taxation is nothing new. In a letter to U.S. President Franklin D. Roosevelt in May of 1937, then Secretary of the Treasury Henry Morgenthau, Jr. described one of the primary tactics being used by wealthy United States taxpayers to avoid paying income taxes that would normally be due as "… setting up foreign personal holding corporations in the Bahamas, Panama, Newfoundland, and other places where taxes are low and corporation laws lax."[2] Today, the use of offshore corporations, foreign trusts and other nominee entities formed in various offshore secrecy jurisdictions for the sole purposes of avoiding payment of required taxes has grown significantly.

While offshore tax havens have often been romanticized by Hollywood and in novels as places where drug dealers, spies, embezzlers and other nefarious types hide their illicit income to avoid detection by law enforcement authorities, the reality is that fiction has not always been that far from the truth. Numerous congressional hearings, government reports, independent studies, media articles and international efforts have clearly documented the use of financial secrecy jurisdictions and offshore financial centers throughout the years for money laundering, illegal funds transfers, asset protection and tax evasion. One need look no further than the financial affairs of former dictators such as Idi Amin, Muammar Gaddafi, Manuel Noriega, Ferdinand Marcos and others who plundered the wealth of their own nations and then hid them away in secret Swiss bank accounts.

But it is no longer just the wealthy and the powerful that hide money offshore in order to avoid paying taxes, and it is not just Swiss banks that are providing financial secrecy. The expansion of the global economy, the development of the Internet and the resulting ease of conducting cross-border financial transactions have led to an explosion of offshore tax evasion as recent investigations by the United States into UBS AG, HSBC, Wegelin Bank and others have clearly documented. This new international financial environment also has led to the development of a global tax evasion industry made up of attorneys, accountants,

1 The Price of Offshore Revisited, Tax Justice Network (July 2012)

2 Letter of Henry Morgenthau, Jr., Secretary of the Treasury, to President Franklin D. Roosevelt regarding tax evasion date May 29, 1937, Franklin D. Roosevelt Presidential Library, Hyde Park, New York

Financial secrecy and offshore tax evasion have become very big business.

bankers, brokers, financial advisors, wealth managers, trust providers, corporate service providers and other professionals who promote, facilitate and enable it.

Financial Secrecy and The Business of Offshore Tax Evasion

Offshore tax evasion is all about creating the appearance of international legitimacy and disguising actual beneficial ownership of financial assets and income while still retaining personal control, use and enjoyment of the assets and the income they generate. It is about the form rather than the substance, it is about the appearance rather than the reality, it is about fiction rather than fact.

Aided by a cadre of professional facilitators and enablers, taxpayers and their financial advisors often devise elaborate and complicated offshore tax schemes that on paper may appear legitimate but in reality are nothing more than shams. These complex offshore financial structures and arrangements are specifically designed to mislead others and create a false impression of legitimacy while disguising true beneficial ownership and the economic realities of what is actually taking place. Offshore tax schemes generally involve the formation and use of multiple offshore shell corporations, trusts and other foreign entities in combination with multiple offshore secrecy jurisdictions to further obscure what is really occurring. However, at the core of every offshore tax scheme will be an arrangement that allows the taxpayer to ultimately retain personal control over the accounts, funds and/or assets regardless of the offshore structure that has been put into place.

Offshore secrecy jurisdictions have enacted strict financial secrecy laws that prohibit banks, bank employees and others from disclosing financial information for any reason. Some secrecy jurisdictions, such as Switzerland and Liechtenstein, have even made disclosure of financial information a criminal offense punishable by imprisonment. Individual bank policies and industry practices also contribute to this fostering of anonymous ownership of financial accounts and assets within secrecy jurisdictions. By providing the means and opportunity for concealing the true ownership and control of offshore assets, the relationships among supposed "unrelated" entities and the economic realities of offshore financial transactions, financial secrecy jurisdictions have developed a culture of secrecy that makes them very attractive to those seeking to avoid payment of required taxes.

Offshore secrecy jurisdictions have enacted strict financial secrecy laws...

It is important to acknowledge at the outset that it is not inherently illegal to form offshore entities and maintain bank accounts, securities accounts and other financial assets in offshore secrecy jurisdictions. In fact, there may be legitimate business reasons for establishing such financial structures in today's globalized economy. However, it is decidedly illegal to underreport taxable income, hide assets and evade payment of required taxes by using sham entities, offshore accounts and phony offshore structures and arrangements as part of a scheme to hide income. And while it is true that not all financial assets held in offshore secrecy jurisdictions involve tax evasion monies, there are very few who would deny that tax avoidance is the primary motivating factor behind the lion's share of it.

This culture of secrecy has resulted in the development of a global tax evasion and asset protection industry made up of attorneys, accountants, bankers, brokers, financial advisors, wealth managers, trust providers, corporate service providers and other professionals that support and promote the industry. While some are resident in the offshore secrecy jurisdictions themselves, many are actually located in the home countries of the taxpayers seeking to avoid paying tax. In a number of secrecy jurisdictions, the offshore financial sector has grown so large as to become one of the predominant employers of local citizens and residents and is highly respected and regarded by locals, even though much of its business

model is focused on assisting citizens and residents of other sovereign nations commit criminal violations of their own home country's tax laws.

The Facilitators and Enablers

Working in cooperation with one another, offshore financial centers, financial institutions and offshore professionals create an environment of anonymous ownership of financial assets and discreet control that are at the core of offshore tax evasion schemes.

- Offshore financial centers provide the financial secrecy laws and various other advantages to non-citizens domiciled outside the secrecy jurisdiction. Often, these include favorable laws for corporations, trusts, foundations and other legal entities or arrangements as well as low or no taxation on business conducted outside their borders.
- Banks and other financial institutions provide the bank accounts, brokerage accounts, investment vehicles, insurance policies, etc. that form the basis of an abusive offshore tax scheme. They also facilitate the cross-border transfer of assets between domestic accounts and offshore accounts, the covert ownership and control of offshore assets and accounts, and may assist by providing documents and statements needed to hide true ownership.
- Offshore professionals provide the entrée and access to the offshore financial world. They create and promote the offshore tax schemes, form the offshore entities needed, open the offshore accounts, assist in the covert transfer of funds and other assets, manage portfolios, arrange for nominee corporate officers and directors, secure predetermined legal opinions when needed and more. Offshore entities commonly used in the creation of offshore tax schemes include International Business Companies (IBC), Personal Investment Companies (PIC), Protected Cell Companies (PCC), Foreign Trusts, Foreign Partnerships, Foundations and more.

Those who work in the financial secrecy world will often say that it is not their responsibility to enforce the tax laws...

Those who work in the financial secrecy world will often say that it is not their responsibility to enforce the tax laws of other countries and that they are simply providing a service that is in demand and is legal to provide in their home country. But the recent high profile criminal investigations conducted by the United States into the cross-border activities of UBS AG of Switzerland, Wegelin Bank of Switzerland and others have clearly shown that they do far more than that.

In February of 2009, UBS AG, the largest international bank in Switzerland admitted in a deferred prosecution agreement that it had conspired with United States taxpayers in committing the criminal act of tax evasion. It didn't just accomplish this by sitting in Geneva or Zurich or Lucerne waiting for U.S. taxpayers to show up on their doorsteps, it accomplished this by secretly sending it's employees into the United States where they engaged in illegal banking activities that included soliciting U.S. taxpayers to open secret bank accounts with full knowledge that it was helping them commit tax evasion. This wasn't Swiss bankers doing what they do legally in Switzerland, this was Swiss bankers doing what they do illegally while standing upon the sovereign soil of the United States of America. In furtherance of their illegal tax evasion activities, they also used encrypted laptop computers and counter-surveillance techniques while traveling in the U.S. and, in some cases, established secret codes for communicating with clients. UBS ultimately agreed to plead guilty to a criminal charge of conspiracy, paid a $780 million fine, agreed to exit the U.S. cross-border banking business and turned over to the IRS the identities and account records of nearly 5,000 high wealth U.S. clients with secret offshore bank accounts.[3]

3 http://www.justice.gov/tax/UBS_Signed_Deferred_Prosecution_Agreement.pdf,

http://www.irs.gov/pub/irs-drop/bank_agreement.pdf

In January of 2013, Wegelin Bank, the oldest private bank in Switzerland, pleaded guilty in New York City to criminal charges that for nearly a decade the firm had helped more than a 100 wealthy American customers evade taxes by hiding more than $1.2 billion in secret accounts.[4] Bank officials acknowledged that the bank had campaigned UBS's departing U.S. clients to move their secret accounts to Wegelin where they would continue to remain secret and tax-free. Bank officials further acknowledged that the bank had believed it could not be prosecuted in the United States because it had no offices here, and had acted in accordance with Swiss law. In a startling admission of particular interest, they also said that this type of conduct was a common practice in the Swiss banking industry. Wegelin ultimately pleaded guilty to the criminal charges, paid $74 million in fines, restitution and forfeited funds, closed its doors and ceased operations.

4 http://www.justice.gov/usao/nys/pressreleases/January13/WegelinPleaPR.php

In addition to the criminal charges against UBS and Wegelin, indictments and other criminal charges have been filed by the United States against 19 private bankers employed by various Swiss banks plus 8 independent financial advisors and 2 attorneys who assisted them and approximately 50 U.S. taxpayers in using secret offshore accounts at various offshore banks to commit tax evasion. Some of these have entered guilty pleas in connection with the charges, some have been convicted at trial and others have been declared fugitives.

The U.S. Internal Revenue Service also announced three limited time Offshore Voluntary Disclosure Initiatives following the UBS case that resulted in more than 38,000 taxpayers coming forward voluntarily to declare secret accounts previously hidden in various offshore secrecy jurisdictions around the world. Those taxpayers have paid more than 5.5 billion U.S. dollars in back taxes and penalties and have provided a wealth of information about their offshore dealings and the offshore professionals, both domestic and foreign, who facilitated and enabled them that will likely lead to further investigations and further charges.

In furtherance of their illegal tax evasion activities, they also used encrypted laptop computers and counter-surveillance techniques...

The international community has made much progress in addressing the damaging effects caused by the offshore tax evasion industry, its drain on national treasuries and the negative impact that results to civil society, but there is still much work to be done. In addition to the efforts the United States has made, various other nations including the United Kingdom, Canada, France, Germany and India have initiated programs seeking to recover tax revenues lost due to the financial secrecy Switzerland provides. OECD and other international organizations have sought to identify and highlight offshore secrecy jurisdictions and build an international consensus for addressing the financial harm they cause to other nations.

Notwithstanding, financial secrecy jurisdictions, offshore tax havens and the professionals that facilitate and enable them continue to flourish. In a financial world where 32 trillion U.S. dollars in unreported wealth is being held in financial secrecy jurisdictions around the world, the UBS and Wegelin cases, as important and precedent setting as they are, represent only the tip of the iceberg.

Attorneys and Claims of Privilege

A particularly disturbing trend in offshore tax evasion has been the steady blurring of the distinction between what constitutes legal tax avoidance with what constitutes illegal tax evasion with respect to offshore tax arrangements, and the willingness of some in the legal community to involve themselves in facilitating and enabling the activity.

Offshore tax schemes are marketed on a supposition that what is taking place is perfectly

legal. These schemes are usually developed by private bankers, accountants and financial advisors and are then reviewed by attorneys who give them their legal stamp of approval. More often than not, these legal reviews look only to the structures involved and the form of the arrangement, rather than to the substance and economic realities of what is occurring. In some cases, attorneys even work directly with the private bankers, accountants and financial advisors in devising the very schemes that they then approve.

In other cases, law firms provide full service operations where they perform all aspects of assisting taxpayers in using offshore secrecy jurisdictions to avoid tax. In addition to devising the overall scheme, these law firms will assist in the formation and management of offshore companies and foreign trusts, arrange for nominee officers and directors as needed, secure offshore bank accounts and securities accounts in the names of the nominee entities, act as an intermediary for correspondence between the banks and the taxpayer, assist in the covert transfer of funds and more. Despite the fact that these law firms are providing purely business services to their clients, rather than legal counseling, they will often claim that all of their activities are protected by attorney-client privilege.[5]

Despite the fact that these law firms are providing purely business services to their clients, rather than legal counseling, they will often claim that all of their activities are protected by attorney-client privilege.

In August 2006, the U.S. Senate Permanent Subcommittee on Investigations issued a report titled Tax Haven Abuses: The Enablers, The Tools And Secrecy[6] after conducting an extensive investigation into how offshore and U.S. financial professionals help U.S. citizens conceal and secretly utilize offshore assets, while undermining, circumventing, or violating U.S. tax, securities, and anti-money laundering laws. At the conclusion of its report, the Subcommittee included a specific section to detail the involvement of law firms in facilitating and enabling offshore tax abuses.[7]

The report states in part,

> "The evidence reviewed by the Subcommittee shows that a battery of law firms was integral to the design and implementation of the tax and offshore structures discussed in this Report."[8]

With respect to claims of legal privilege and its impact on the Subcommittee's investigation, the report goes on to state,

> "The Subcommittee's access to documentary evidence from the law firms was limited, and representatives of the law firms were constrained with respect to some of the matters they could discuss, because much of the material was subject to claims of attorney-client privilege. It was therefore difficult to determine in many instances all of the facts the law firms used in formulating their opinions and advice, and precisely what advice the law firms actually provided to their clients. Nonetheless, the Subcommittee was able to obtain sufficient evidence to document the critical role played by law firms and to show that the activities and transactions reported in previous sections took place with heavy involvement of and reliance on legal counsel."[9]

The report concludes with the statement that,

> "The evidence reviewed by the Subcommittee raises serious questions about what facts the law firms used in formulating and providing their opinions, services, and advice; what advice was actually provided to the clients in some circumstances; and whether the firms had adequate practices in place to identify and review client matters that could pose significant controversies. At issue is whether, and to what extent, professionals – including lawyers – have an obligation to evaluate the facts underlying the transactions on which they opine and advise."[10]

5 http://www.offshorelawcenter.com, https://www.offshore-protection.com/about-sovereign-management-and-legal.html

6 http://www.hsgac.senate.gov/subcommittees/investigations/hearings/tax-haven-abuses-the-enablers-the-tools-and-secrecy

7 Ibid., p. 388

8 Ibid

9 Ibid.

10 Ibid., p. 397

While the rules regarding attorney-client privilege vary by country, the general standard applied by all is that attorney-client privilege exists to protect the rights of the clients and to ensure that clients can openly and candidly discuss legal matters with their attorneys without fear that their discussions will be disclosed to others, made public or made available to law enforcement or other governmental officials. The privilege is not intended to insulate the attorney from personal responsibility for unlawful activities, nor to provide a safe haven for clients to secretly engage in illegal activities, with or without the lawyer's assistance, by hiding behind the protective shield of a law practice.

Clearly, the legal profession and legal privilege are vital, noble and necessary components of a free and civilized society, and most lawyers and law firms carry out their responsibilities with distinction and honor. Attorneys represent the legal conscience of society, and they should always act to protect their clients' interests by ensuring that clients do not run afoul of the law. The attorney's mandate should always be to help clients avoid breaking the law, rather than helping them circumvent, undermine or violate the law, nor should they be helping clients market financial products to others that are based on false legal representations. Unfortunately, the growth of the global economy, the ease of conducting cross-border transactions and the absolute secrecy provided by offshore secrecy jurisdictions have caused some to see very little difference between legal tax avoidance and illegal tax evasion … and when that happens, we all lose.

The privilege is not intended to insulate the attorney from personal responsibility for unlawful activities, nor to provide a safe haven for clients to secretly engage in illegal activities, with or without the lawyer's assistance, by hiding behind the protective shield of a law practice.

Form and substance:
Multinational corporations and tax planning

By Professor Guttorm Schjelderup[1],
Norwegian Center for Taxation at NHH Norwegian School of Economics

The Norwegian version of this article was previously published in *Samfunnsøkonomen* yr. 127, no. 1, pp. 26-31. It is translated and published with permission from the Norwegian Association of Economists.

Agnar Sandmo's research on tax evasion has contributed to my interest in tax planning and tax evasion. This article outlines how multinational corporations reduce their tax burdens through transfer prices, thin capitalisation and the use of channelling solutions and holding companies in tax havens. The article asks whether the taxation of multinational corporations is overly focused on legal form, and discusses potential future implications for corporate taxation.

1. Introduction

The fact that many large multinational corporations hardly pay any corporate income tax has sparked fierce debate internationally. The financial crisis and the need to increase tax revenues have added focus to this issue. In Europe, the debate got underway after the Reuters news agency prepared a report on how Starbucks avoids corporate income tax in the United Kingdom.[2]

The report noted that the UK turnover of Starbucks, from the opening of its first UK cafes in 1998 until and including 2011, was in excess of NOK 3 billion.[3] However, the company has only paid NOK 86 million in tax over this period, and the reason why the company has paid any tax at all is that the tax authorities have disallowed some of the costs claimed as deductibles by the company. For the years 2009, 2010 and 2011, Starbucks paid no corporate income tax in the United Kingdom, despite very high sales revenues. And in aggregate over the last 14 years, the company paid only 1% tax on gross sales revenues in the United Kingdom.[4] In comparison, German companies that are not multinationals paid an average of 30% tax on their earnings in 2008 (see Bauer and Langenmayr p. 1, 2012). Another example is the web retailer Amazon, which accumulated sales revenues of NOK 7.6 billion over the period 2009-2011, but registered no taxable profit over that same period.[5] Companies like Apple and Google also pay very little tax on their non-US earnings. The tax burden of both of these has been 1.5 – 2.5% of gross sales revenues in recent years.[6]

> ...in aggregate over the last 14 years, the company paid only 1% tax on gross sales revenues...

The reason why these companies pay so little tax is that their tax deductible costs are close to matching, or even exceeding, their taxable revenues. This raises the question of whether the costs are exaggerated or whether the revenues are underreported. It should in this context be emphasised that all of the said companies have been under government scrutiny. None of them are accused of engaging in tax evasion. What they have engaged in is sophisticated tax planning, which exploits weaknesses in national and international legal frameworks, in combination with the use of subsidiaries in countries associated with the term "tax haven".

1 I would like to thank Ingebjørg Vamråk Dobrovolkis, Jarle Møen, Tormod Torvanger, Paul Gunnar Larsen, Astrid Shoghl and Oddleif Torvik for constructive comments. The author gratefully acknowledges financial support from the Research Council of Norway, the Directorate of Taxes and the SNF research program Crisis, Restructuring and Growth.

2 http://www.reuters.com/article/2012/10/15/us-britain-starbucks-tax-idUSBRE89E0EX20121015

3 All examples used assume a NOK/GBP exchange rate of 10

4 http://www.bbc.co.uk/news/business-20288077 and http://www.bbc.co.uk/news/business-19967397.

5 http://www.guardian.co.uk/technology/2012/apr/04/amazon-british-operation-corporation-tax.

6 http://www.bbc.co.uk/news/business-20197710 and http://www.telegraph.co.uk/technology/google/9460950/Google-pays-just-6m-UK-tax.html.

Translated by Knut Engedal. Norwegian original title: "Form og substans: Flernasjonale selskaper og skatteplanlegging.

The above company examples are not exceptional cases. Maffini and Mokkas (2009) show that multinational enterprises systematically report higher productivity (and thus earnings) in low-tax countries. And international studies generally show that multinational corporations register lower profitability in high-tax countries than do domestic corporations within the same industry.[7] Such is also the case for Norway. Balsvik et al. (2009) find, for example, that the profit margins registered by multinational enterprises in Norway are 1.5 to 4 percentage points below those of comparable domestic enterprises.[8] Egger, Eggert and Winner (2010) find, by using a large set of European corporation data, that multinational corporations pay 32% less tax in high-tax countries than do comparable domestic corporations.

7 These findings are also interesting from the perspective of international studies showing that the productivity of multinational corporations is considerably higher than that of domestic corporations. See Head and Ries (2003) and Helpman et al. (2004).

8 Which is, incidentally, in line with the findings of Langli and Saudagaran (2004).

I will in the following outline how multinational corporations reduce their tax burdens through tax planning. It should be emphasised that there is often a grey area between entirely lawful tax planning and tax evasion. The exact demarcation of the border between the two may be a matter of legal interpretation, and will therefore at times end up in the judicial system.[9]

9 Consequently, aggressive transfer pricing strategies entail a certain probability of incurring back taxes and penalty taxes (cf. the model devised by Allingham and Sandmo (1972).

2. Multinational corporations and tax planning

Unlike domestic corporations, multinational corporations may relocate profits to low-tax countries by exploiting differences between national tax systems. The two most commonly used strategies are transfer pricing and thin capitalisation. By "thin capitalisation" I refer to the practice of structuring companies with a very high proportion of debt relative to equity. By reallocating debt to a subsidiary in a high-tax country, taxable income in such high-tax country is reduced through the deductibility of interest costs. Such relocation of debt is profitable because the tax savings in the high-tax country outweigh the tax liabilities incurred by the lending company, which company will typically have its tax domicile in a low-tax country.

...a core issue is how aggressive the pricing can be before the authorities intervene.

The value of such relocation of debt is maximised if group executives structure the loan such as to make the lender a subsidiary (often referred to as an internal bank or financial centre) located in a tax haven that levies no corporate income tax. The tax savings will in such case be equivalent to the value of the tax savings in the high-tax country, i.e. rtD, with r being the loan interest rate, D the loan amount and t the tax rate. In addition, multinational corporations may have some leeway in setting the interest rate on such internal loans because they may, inter alia, argue that the loan is project-related and entails more risk than is reflected in the market interest rate. This makes the strategy even more profitable.[10]

10 In Norway, thin capitalisation adjustments are premised on Section 13-1 of the Tax Act and the OECD arm's length standard. Case law concerning the overruling of capital structures for tax purposes is exemplified by the Fornebu judgment, published on p. 598 onwards of the Retstidende court reporter for the Supreme Court of Norway.

Most countries protect themselves against thin capitalisation by either having explicit rules stipulating when a company has excessive debt; so-called thin-capitalisation rules, or by applying the provision in the OECD Model Tax Convention to the effect that any loan must comply with the arm's length principle. The latter implies that any loan shall be granted on market terms, i.e. that the loan agreement might have been concluded by independent parties within the same industry. Some countries, like Germany and Austria, have rules that explicitly specify when the debt-equity ratio of a company is excessive.[11] Norway uses the arm's length standard, but we also have implicit rules on the demarcation of thin capitalisation limits for certain industries on the basis of case law.

11 See Ruf and Schindler (2012) for an overview of the thin capitalisation literature.

Transfer pricing encompasses the pricing of goods, services, financial instruments and intellectual property in transactions between associated companies. Most countries apply the OECD arm's length standard for purposes of determining the appropriate price. The said standard holds that the appropriate price is the market price, i.e. the price that would have been agreed between two independent parties. It goes without saying that it can often be difficult to find market parallels suitable for confirming the appropriate price. And the challenge is of course even more pronounced when faced with the pricing of intellectual property, which happens to be one of the main ingredients in the business concept of many of the multinational corporations discussed above. Karinsky and Riedel (2009) find, in an empirical study of multinational

corporations, that these tend to locate patent ownership in low-tax countries, and not in the country where the research behind the patent was carried out. The Directorate of Taxes has estimated that transfer pricing modified the income of companies in Norway by NOK 9 billion, 8.5 billion and 16.7 billion for the years 2009, 2010 and 2011, respectively.12

12 Annual reports of the Directorate of Taxes: www.skatteetaten.no/no/Bedrift-og-organisasjon/Drive-bedrift/Aksjeselskap/Internprising/arsrapporter

Transfer pricing may take different forms, depending on what is traded between associated companies. One way of transferring intellectual property is by cost sharing. This involves a subsidiary in a low-tax country (often a tax haven) entering into an agreement requiring it to cover some of the development costs, in return for exclusive rights to sell the resulting product without paying royalties. We might, for example, envisage an Irish subsidiary concluding an agreement with its US parent company, pursuant to which it will pay part of the costs associated with the development of a piece of software in return for exclusive rights to sell the resulting product within a specific geographical area.

The exact demarcation of the border between the two may be a matter of legal interpretation, and will therefore at times end up in the judicial system.

Under cost-sharing agreements, the parent company may establish a wholly-owned subsidiary in a low-tax country, fully funded by equity from the parent company. The subsidiary may use such equity as its contribution under the cost-sharing agreement if thus permitted under the legal framework. Cost-sharing agreements raise, inter alia, matters of principle with regard to risk sharing, especially in those cases where the subsidiary has received all capital to fund the agreement from its parent company. It is also of interest to note that a parent company that establishes a wholly-owned subsidiary may negotiate the cost-sharing price with the subsidiary. The subsidiary is, after all, created by the parent company, thus implying that the parent company is conducting negotiations with itself. However, the state of the law in this regard is that two independent legal entities may conclude agreements between themselves, irrespective of whether one of these entities originates from the other. The legislation concerning what may be agreed between a parent company and a subsidiary under cost-sharing arrangements may vary from one country to another. Hence, the details of the legal framework in each country may have a major impact on the profitability of assigning the sales rights pertaining to a product by way of such an agreement.

Another type of transfer pricing is involved when associated companies assign ownership of a finished product between themselves. In such cases, the arm's length standard will continue to apply, but a core issue is how aggressive the pricing can be before the authorities intervene. The authorities will usually require documentation demonstrating that the pricing is in conformity with the arm's length principle, but companies often have some degrees of freedom at their disposal, especially with regard to discretionary assessments.[13] Such room for manoeuvre, in combination with intra-group transactions and the right to carry losses forward, enables multinational corporations to reap a tax advantage that is not available to domestic corporations. In the long run, such competitive advantages will have an impact on who owns businesses. Multinational corporations are also advantaged inasmuch as they can channel attractive business opportunities, offering high returns, through a subsidiary located in a low-tax country. Of course, domestic corporations can also establish a foreign subsidiary for such purposes, but this may take time, and time is often money.

13 The arm's length principle laid down in Section 13-1 of the Tax Act may be interpreted in conformity with the OECD guidelines on the appropriate price in transactions between enterprises with a commonality of interest.

3. How is it done? Double Dutch sandwiches

In order to illustrate the challenges faced by the authorities in the taxation of large multinational corporations, I will here outline the most frequently discussed example of international tax planning, i.e. how Google has organised its business. The reason why Google has ended up in the limelight is not that the company has done anything that is particularly extraordinary, but rather that the way in which it is organised is representative of what large multinational corporations do, and that this is premised on key elements of international tax law.

In 2003, Google Inc. in the United States concluded a cost-sharing agreement with its wholly-owned and newly incorporated subsidiary Google Ireland Holdings.[14] The subsidiary was incorporated and had its registered address in Ireland, but since the company was managed at Board level from Bermuda, the legal framework in most countries would hold that the company has its tax domicile in Bermuda. The corporate income tax rate in Bermuda is zero. The cost-sharing agreement gave Google Ireland Holdings the right to sell the Google search and marketing services free of charge in Europe, the Middle East and Africa, in return for the company covering development costs in proportion with these geographical regions' share of global sales.

14 The below discussion is based on Kleinbard (2012).

The cost-sharing agreement became the subject of a dispute with the tax authorities in the United States, but in 2006 it was approved through a so-called Advanced Pricing Agreement. Such agreements are confidential, and hence it is not possible to opine on whether the agreement priced the transaction inappropriately. Google Ireland Holdings thereafter licensed its rights to its subsidiary Google BV, which is registered and tax domiciled in the Netherlands. Google BV sub-licensed the rights to its subsidiary Google Ireland Ltd., which is tax domiciled in Ireland. Google Ireland Ltd. then licensed these rights to subsidiaries in Europe, the Middle East and Africa, and has since earned large revenues from such licensing, as well as from direct sales to customers. The company structure is presented in Chart 1.

In total, Google paid 2.4% tax annually over the period 2007-2009.

The rationale behind this structure is to transfer most of the revenues from sales in Europe, the Middle East and Africa to Google Ireland Holding, which is tax domiciled in Bermuda (where the corporate income tax rate is zero). The subsidiaries in these countries pay large amounts in royalties to Google Ireland Ltd., and these are tax deductible, thus leaving these companies with modest profits.[15] Likewise, the royalty payments from Google Ireland Ltd. to Google BV (in the Netherlands) are of such magnitude as to also prevent Google Ireland Ltd. from earning any sizeable taxable profits. Google could not have channelled the revenues of Google Ireland Ltd. directly into Google Ireland Holding (tax domiciled in Bermuda), because withholding tax would then have been levied on the royalty amounts in Ireland. This is why the royalty amounts are first transferred to Google BV, which is a company located within the EU single market, and thus exempted from withholding tax in Ireland. The Netherlands are chosen as recipient because the Netherlands do not levy withholding tax on royalties paid to Bermuda. Consequently, the Netherlands are a highly attractive location for purposes of channelling such revenues.

15 It is not known what work the 2,000 employees of Google Ireland ltd. perform. It is likely that some of them are engaged in research and development in connection with the cost-sharing agreement with Google Inc., whilst others are involved in sales (see Kleinbaird, 2012).

The Netherlands get compensated for not charging withholding tax by levying a minor tax on the difference between the royalty amount received by Google BV and the amount passed on to Google Ireland Holding. This tax is subject to negotiations, and the agreement between Google and the Dutch tax authorities is not in the public domain. In total, Google paid 2.4% tax annually over the period 2007-2009 on its non-US revenues, according to Bloomberg Business Week Magazine.[16]

16 http://www.businessweek.com/magazine/content/10_44/b4201043146825.htm

4. Some concluding remarks

An interesting question is whether Norwegian multinational corporations could have used an arrangement similar to that of Google. Norwegian companies can distribute dividends to the Netherlands without incurring any tax liability, because the exemption method applies within the EU single market. The key issue is therefore whether the Norwegian tax authorities would – if they knew that dividends from a company tax domiciled in Norway were to be channelled outside the European Economic Area (EEA) via a Dutch company – have levied withholding tax on the dividends in Norway. This issue will be judicially reviewed in the so-called Transocean case.[17] The main rule under the tax treaties is that the taxation powers are held by the source state. If multinational corporations in Norway are able to distribute dividends to corporate

17 This issue is referred to as the "dividend matter" in the Transocean case.

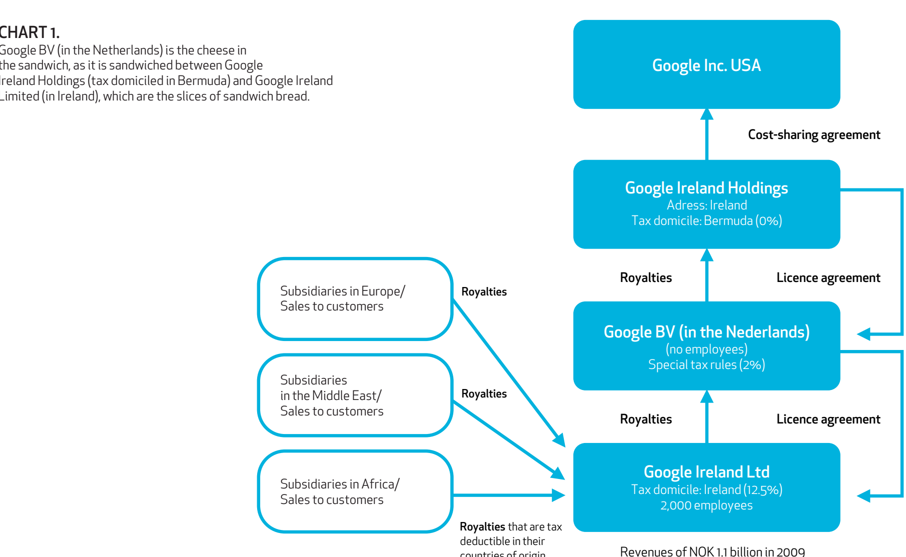

CHART 1.
Google BV (in the Netherlands) is the cheese in the sandwich, as it is sandwiched between Google Ireland Holdings (tax domiciled in Bermuda) and Google Ireland Limited (in Ireland), which are the slices of sandwich bread.

shareholders outside the EEA via, for example, the Netherlands, without any withholding tax being incurred in Norway, it means that the source principle is being undermined. Such a state of law would imply that the Norwegian tax base is narrower than would otherwise have been the case, which will impair the efficiency characteristics of the tax system.

The arrangements made by Google demonstrate that multinational corporations can avoid the payment of withholding tax, partly because some countries apply legal provisions that undermine the source principle, and partly because multinational corporations can reallocate profits to low-tax countries by way of thin capitalisation and various transfer pricing strategies. In addition, there are examples of identical revenues or costs being classified differently by different countries, which gives rise to arbitrage opportunities. Such issues are challenging in themselves, but a further consideration is that it is very costly, in purely administrative terms, for the tax authorities to enforce the arm's length standard.

It is important, in the application of law, that taxation be based on statutory purpose and/or economic substance, rather than legal form. This is not readily achieved unless one has a set of anti-avoidance provisions that can be applied to determine the economic substance of international transactions. And it is an open question whether it is possible to devise such a list that cannot be circumvented.

It is important, in the application of law, that taxation be based on statutory purpose…

Since multinational corporations have such considerable scope for avoiding taxation, when compared to domestic corporations, one may ask whether the difference has become sufficiently large to threaten the very foundations of corporate taxation. Or to rephrase it: Why should we tax domestic corporations more heavily than multinational corporations? And is it feasible to achieve taxation equality? The answer to the latter question depends on whether one can bring about amendments to the legal provisions that currently facilitate the arrangements I have discussed above. This is further dependent on countries like, for example, the Netherlands not deeming it to be in their interest to serve as a channelling point for dividends.

The loss of tax proceeds from abolishing corporate income tax on onshore businesses would be considerable. Estimated budget figures for Norway in 2012 are approximately NOK 83 billion. It is, at the same time, evident that e-commerce is growing in importance. Apple does, for example, sell a significant portion of its products in Norway through its "Apple Store", which is operated by Google Ireland Ltd. The company pays VAT in Norway on its sales here, but does not pay corporate income tax since the sales are made by the company in Ireland. An increase in the volume of such activities is, when taken in isolation, an argument in favour of increasing the rate of VAT, as this is the only tax capable of functioning as an implicit withholding tax in such cases.

Some of the problems I have outlined above have to do with international tax law and countries offering to serve as channelling points and safe harbours for the profits of multinational corporations. These problems have been created by international capital movements between countries with different tax levels. Free trade has been an international phenomenon for more than 50 years, whilst we have experienced free capital movements for a much briefer period of time (in Norway since 1992, when the foreign exchange legislation was liberalised). In the same way that the World Trade organization has a role to play in facilitating trade between countries, the problems I have outlined above show that we need to rethink the legal provisions governing international capital movements, at both the national and the international level.

…we need to rethink the legal provisions governing international capital movements…

Maybe Morten Eriksen, Senior Public Prosecutor at the Norwegian National Authority for Investigation and Prosecution of Economic and Environmental Crime (ØKOKRIM) (2012), and Allison Christians, Professor of Tax Law at McGill University (2012), are right in arguing that a legal fiction industry is in the process of ruining law (Eriksen, 2012; Christians, 2012). A good tax system is one of the most important foundations of a well-functioning economy. It is therefore important to emphasise the substance of transactions, in order not to impair the basis for development and welfare that has been established by optimal taxation theory.

The challenges faced at the international level are formidable. Traditionally, the OECD has served in a coordinating role as far as tax treaties are concerned. The OECD is, at the same time, representing the rich countries, and these issues are global in nature. Many of the countries that currently contribute to undermining the role of the tax system in the global economy have strong interests in preserving the status quo. This also means that the UN cannot readily be expected to resolve the matter. What is certain is that more research is needed on the effects of asymmetric tax burdens between national and multinational corporations.

Bibliography

Allingham, M.G., and Sandmo, A., (1972). Income tax evasion:
A theoretical analysis. Journal of Public Economics 1, 323-338.

Balsvik, R., Jensen, S., Møen, J., and Tropina, (2009). "Economic research findings on the transfer pricing of multinational corporations in Norway: State of knowledge." (In Norwegian only. Norwegian title: Kunnskapsstatus for hva økonomisk forskning har avdekket om flernasjonale selskapers internprising i Norge). SNF Report 11/09.

Bauer, J.C., and Langenmayr, D., (2012). Sorting into outsourcing:
Are profits taxed at Gorilla's arm's length? Forthcoming, Journal of International Economics.

Christians, A. (2012): "Legal circumventions: When does the form have to give way to the substance in tax matter?", presentation to the conference on Financial Secrecy, Vested Interests and Society, Norwegian School of Economics (NHH). Presentation available at http://pwyp.no/sites/all/files/3_Ms.Allison_Christians_Form_v_Substance_PWYP-NorwayNOV12PDF_0.pdf

Egger, P., Eggert, W., and Winner, H., (2010). Saving taxes through foreign ownership.
Journal of International Economics 81, 99-108.

Eriksen, M., (2012). Vil jurister ødelegge jussen? Skatterett 3 (31), 179 – 185.
(In Norwegian. English translation available: Will lawyers ruin law?)

Karinsky, T., and Riedel, N., (2009). Corporate taxation and the choice of patent location with multinational firms.
Oxford University Centre for Business Taxation. Working paper 08/20

Kleinbaird, E.D., (2011). "Stateless Income". Florida Tax Review 11 (9), 700-770.

Grubert, H., Goodspeed, T., and Swenson, D., (1986). Studies in International Taxation chap. Explaining the low taxable income of foreign controlled companies in the United States, 237 – 270. University of Chicago Press.

Head, K., and Ries, J., (2003). Heterogeneity and the FDI versus export decisions of Japanese manufacturers.
Journal of the Japanese International Economies 17, 448-467.

Helpman, E., Melitz, M.J., Yeaple, S.R., (2004). Export versus FDI with heterogeneous firms.
American Economic Review 94, 300-316.

Langli, J.C., and Saudagaran, S.M., (2004). Taxable Income Differences Between Foreign and Domestic Controlled Corporations in Norway. European Accounting Review 13(4), 713–41.

Maffini, G., and Mokkas, S., (2009). Profit-shifting and measure of productivity of multinational firms.
Oxford University Centre for Business Taxation. Working paper 09/20.

Ruf, M., and Schindler, D., (2012). Debt shifting and thin-capitalization rules
– the German experience and alternative approaches. NHH Discussion Paper RRR 06.

Legal Professional Privilege:

England and Wales

Tim Daniel - Partner, Edwards Wildman Palmer UK LLP
Antonio Suarez-Martinez - Partner, Edwards Wildman Palmer UK LLP
Henry Stewart - Associate, Edwards Wildman Palmer UK LLP

According to Lord Justice Goff "legal professional privilege is a very necessary thing and is not lightly to be overthrown". Whilst his comment remains a valid description of how legal professional privilege is treated today, nearly thirty-three years later, what does it mean in real terms in an era where, in certain circumstances, the law requires the disclosure of information to public authorities?

The short answer is that privilege remains extremely robust in England and Wales, with very few, narrow exceptions[1]. Judges are reluctant to lift privilege over a document without a good reason to do so. Legal advisers maintain the protection of privilege in the majority of circumstances where there is a requirement to report to statutory bodies. However, this is not the full story.

The general rule

The general principle is that confidential communications between client and legal adviser (or between client or legal adviser and a third party) are privileged from production if they fall under one of two heads: legal advice privilege and litigation privilege. Together, these are known as legal professional privilege (LPP):

(a) Legal advice privilege covers documents created for the dominant purpose of giving or obtaining legal advice. This applies to the continuum of communication between client and solicitor for this purpose.

(b) Litigation privilege covers documents created for the dominant purpose of giving or obtaining legal advice or gathering evidence in contemplation of litigation or in relation to pending or ongoing litigation. It can cover communications between client or solicitor and a third party, providing they are for the relevant dominant purpose.

The public policy principle behind LPP was articulated by Lord Taylor CJ in R v Derby Magistrate's Court, ex p B [1996] [1] AC 487, when he explained that "a man must be able to consult his lawyer in confidence, since otherwise he might hold back half the truth. The client must be sure that what he tells his lawyer in confidence will never be revealed without his consent."

Both forms of LPP contain a requirement that, in order to be covered by privilege, documents must be confidential (although there is a presumption of confidentiality in communications between solicitor and client – Minter v Priest [1930] AC 558). If a document is in the public domain, it cannot be privileged. However, privilege can be maintained after disclosure of a document to a limited number of third parties, with an express agreement that it will not be disseminated to others.

1 This article focuses on the impact of privilege on the commercial world and does not consider the implications of the Children Act 1989 or the Matrimonial Causes Act 1973.

LPP, more than simply being a rule of evidence, is a substantive right. It therefore applies both during legal proceedings and in other contexts such as investigations and requests for information from public authorities (R (on the application of Morgan Grenfell & Co Ltd) v Special Commissioners of Income Tax [2003] 1 AC 563).

Once a claim to privilege is established, LPP cannot be overridden by the court for any competing public policy considerations as was upheld by the House of Lords in Derby Magistrates, a criminal case where the House would not lift privilege over a former murder suspect's communications with his lawyer to assist in the defence of another suspect.

Where the client is a company, the court may construe it as a narrower class of individuals for the purposes of privilege. For example, in the case of Three Rivers District Council and others v The Bank of England [2004] UK HL 48, the 'client' only consisted of the internal committee of three senior employees (the BIU) set up to investigate a particular issue. All communications between other bank employees and the BIU, or between other employees and the lawyers, were not subject to legal advice privilege. Whilst the 'client' is usually readily identifiable, the term 'client' is still yet to be properly defined by the courts and this can bring with it its own difficulties and ambiguities.

Another consideration is that, where communications occur for one of the purposes relevant to LPP as well as another, distinct, purpose (for example an internal investigation), LPP may not necessarily apply. This occurred in the case of Waugh v British Railways Board [1980] AC 521, where an internal report was prepared in anticipation of litigation but also to enable appropriate safety measures to be taken. The court held that the litigation was not the dominant purpose of the report, so it was not privileged from production.

The court held that the litigation was not the dominant purpose of the report, so it was not privileged from production.

Common-law exceptions

An exception to both forms of LPP applies in the case if crime/fraud which was first established in R v Cox & Railton (cases joined) (1884-85) LR 14 QBD 153, being then applied to civil fraud in Williams v Quebrada Railway, Land and Copper Company [1885] 2 Ch 751. The principle is best summarised in Kuwait Airways Corporation v Iraqi Airways Corporation [2005] EWCA Civ 256, in which Longmore LJ said, "if a person consults a solicitor in the furtherance of a criminal purpose then, whether or not the solicitor knowingly assists in the furtherance of such purpose, the communications between the client (or his agent) and the solicitor do not attract legal professional privilege."

It is important to note that, since the privilege belongs to the client (Wilson (1792) 4 Term Rep. 753; cited in Derby Magistrates), it is the client's actions, not those of the solicitor, which invoke this exception.

(a) R v Cox & Railton is an example of the exception applying to remove LPP, even though the solicitor's conduct was "unobjectionable", since the client misused the legitimate protection for his own fraudulent purposes.

(b) Conversely, in Randolph M Fields v Watts (CA) 22 January 1986, it was alleged that the solicitor had acted fraudulently while the client was innocent, so the privilege remained over their communications.

(c) However, where both solicitor and client are innocent, and are being used as the "tool" of a fraudster (as in R v Central Criminal Court, ex p Francis & Francis [1989] AC 346, 394 (HL)), the exception may apply and privilege may be lost.

The exception will only apply to documents which are part of, or give advice in furtherance of, the fraudulent/criminal purpose (Derby & Co Ltd v Weldon (No 7) [1990] 1 WLR 1156). This includes communications preparatory to the fraud, and also subsequent communications if they are for the purpose of trying to conceal the proceeds (R v Central Criminal Court, ex p Francis & Francis [1989] AC 346, 394 (HL)).

To engage the crime/fraud exception, actual fraudulent/criminal purpose (Crescent Farm (Sidcup) Sports Ltd v Sterling Offices Ltd [1972] Ch 553), or dishonesty (rather than a "failure to maintain good ethical standards" (Gamlen Chemical Company (UK) v Rochem Ltd (No 2) [1980] 124 SJ 276 (CA)) is required. Barclays Bank plc v Eustice [1995] 1 WLR 1238 (CA) further broadened this test, finding that the exception applied in the case of reprehensible conduct "sufficiently iniquitous for public policy to require" disclosure of the documents in question. Commentators have questioned this latter ruling, but it has been followed (e.g. The David Agmashenebeli [2002] EWHC 104 (Admlty)). The 'iniquity principle' from Barclays Bank was also applied to a director's breach of his duty of fidelity in BGGP Managing Partner Limited & Others v Babcock and Brown Global Partners [2010] EWHC 2176 (Ch).

...communications with in-house counsel would not be privileged for the purpose of European Commission investigations...

In Gamlen, as described at the head of this article, Goff LJ stressed that "legal professional privilege is a very necessary thing and is not lightly to be overthrown". To this end, the standard of proof required to lift the privilege is relatively high. While an applicant seeking to lift privilege does not have to satisfy the court on the balance of probabilities that an allegation of fraud would succeed (Derby & Co v Weldon (No 7)), prima facie evidence supporting the allegation (O'Rourke v Darbishire [1920] AC 581 (HL)) or a "strong prima facie case" is required (Barclays Bank v Eustice).

Kuwait Airways Corporation v Iraqi Airways Corporation [2005] EWCA Civ 256 differentiates between the two standards above, suggesting that where evidence of fraud was "free standing and independent", a prima facie case would suffice, but where the allegation of fraud was disputed or formed part of the issue at trial, a very strong prima facie case would be required to lift privilege.

EU investigations

In the UK, communications with an in-house lawyer (providing they are for the relevant, dominant, purpose (rather than general compliance, risk management or managerial work)) are covered by the same rules of privilege as communications with an external legal adviser.

This is not the case in the majority of EU countries, and the European Court of Justice ruled in Akzo Nobel Chemicals Ltd and Akcros Chemicals v European Commission (C-550/07 P) [2010] 5 CMLR 19, that communications with in-house counsel would not be privileged for the purpose of European Commission investigations. While domestic courts will still apply national rules for investigations by domestic authorities, only communications with external lawyers for the purposes and in the interests of the client's right of defence will be privileged in investigations by European authorities.

Statutory exceptions

The general principle with statutory exceptions to privilege is that the court will not imply an exception, as there is a "strong presumption against Parliament intending a statute to operate so as to impair an existing substantive right." (Thanki, The Law of Privilege, 4.79). This principle was stated in R v Secretary of State for the Home Department, ex p Simms [2000] 2 AC 115 (HL), and reinforced by Lord Hoffmann in R (Morgan Grenfell). To displace the presumption, Thanki suggests that explicit support (in the form of "clear language or necessary implication") is required.

Thanki uses the case of McE v Prison Service of Northern Ireland [2009] 1AC 908 (HL) as an illustration of necessary implication. The House of Lords considered that, when drafting part II of the Regulation of Investigatory Powers Act 2000 (RIPA), it is very unlikely that Parliament would have been unaware of the implications of covert surveillance powers on legal professional privilege. In this case, since Parliament did not specifically exclude privileged communications from those which could be subject to surveillance, the House was prepared to accept that the powers were an implied statutory exception to privilege.

However, the Home Office's code of practice for covert surveillance (http://www.homeoffice.gov.uk/publications/counter-terrorism/ripa-forms/code-of-practice- covert) states that special authorisation will be required for surveillance which is likely to uncover privileged communications. Further, paragraph 4.23 of the code says "Where public authorities deliberately acquire knowledge of matters subject to legal privilege, they may use that knowledge to counter the threat which led them to acquire it, but it will not be admissible in court. Public authorities should ensure that knowledge of matters subject to legal privilege, whether or not it is acquired deliberately, is kept separate from law enforcement investigations or criminal prosecutions." Therefore, while a public authority may use RIPA to intercept privileged communications in some (very limited) circumstances, they are extremely unlikely to be admissible in court. The court was not asked to rule on the question of admissibility in Re McE, but Hope LJ considered whether privileged communications may be admissible, and as obiter stated that "basic rules of fairness strongly indicate the contrary."

Any statutory (or other) exception to privilege is subject to challenge on ECHR grounds...

Any statutory (or other) exception to privilege is subject to challenge on ECHR grounds, either under Article 6 (right to a fair trial) in the case of litigation privilege, or Article 8 (right to respect for private and family life) in the case of legal advice privilege. Article 6 is an absolute right, so if it is engaged then there can be no justification for any exception. Article 8, however, may be derogated from in certain circumstances (where necessary in a democratic society under certain public interest justifications).

Tax

(a) In R (Morgan Grenfell), the House of Lords decided that, in the absence of clear wording setting out an exception to LPP, the power under s20(1) of the Taxes Management Act 1970 to issue a notice to produce information and documents relating to tax liability did not apply to documents covered by LPP.

(b) This has been expressly codified in Schedule 36 to the Finance Act 2008, which says at paragraph 23 that information notices under paragraphs 1 & 2 do not apply to documents protected by LPP. Paragraph 28 contains a similar provision for the business premises inspection power. However, in the event of a dispute as to whether they are privileged, the documents must still be produced, but kept in a sealed opaque container for a tribunal to decide their status.

(c) It should be noted that LPP will only protect the client, and will not apply to the legal adviser in their capacity as taxpayer (R v Inland Revenue Commissioners ex p Taylor (No 2) [1990] STC 379, and R v Inland Revenue Commissioners ex p Lorimer [2000] BTC 257).

Money laundering and terrorist activity

(a) Both the Proceeds of Crime Act 2002 (POCA) and the Terrorism Act 2000 (TACT) as amended by the Anti-Terrorism, Crime and Security Act 2001, have failure to report

offences (s330 POCA and s21A TACT). These make failure to report suspicions of money laundering or terrorist activity an offence which, in the case of money laundering, will include tax evasion.

(b) However, both acts provide a defence to legal advisers if acting within the bounds of LPP. s330(6)(b) of POCA states that the offence is not committed if a person "is a professional legal adviser and the information or other matter came to him in privileged circumstances". These are elaborated on in s330(10), but effectively mirror the requirements for LPP. Notably, the Proceeds of Crime Act 2002 and Money Laundering Regulations 2003 (Amendment) Order 2006 (SI 2006/308), in force since 21 February 2006, extends the privilege defence under section 330 POCA to other professional advisers (accountants, auditors or tax advisers) but they must obtain the information under privileged circumstances. This only applies where the same communications with a lawyer would have been privileged.

These make failure to report suspic-ions of money laundering or terrorist activity an offence...

(c) s21A(5)(b) TACT contains a similar privilege defence for the s21A failure to report knowledge or suspicion that a person has committed a terrorist offence, which is also extended to other relevant professional advisers by an amendment inserted by The Terrorism Act 2000 and Proceeds of Crime Act 2002 (Amendment) Regulations 2007 (S.I. 2007/3398).

(d) It is important to note that the crime/fraud exception will still apply in this situation, so any communications preparatory to or in furtherance of money laundering or terrorist activity will not be covered by LPP. The relevant sections of TACT or POCA will, therefore, apply to allow a legal adviser to make a disclosure without breaching their duty of confidentiality to their client.

(e) It should also be noted that LPP is not in itself a defence to committing one of the principal offences under s327-329 POCA and it has been suggested that in many instances it may be deemed safer to make a disclosure in confidence rather than run the greater risks of failing to make a disclosure. However, the Law Society's guidance suggests that it may fall within the "reasonable excuse" defence for not making an authorised disclosure:

"You will have a defence against a principal money laundering offence if you make an authorised disclosure.

However, you are prevented from disclosing if your knowledge or suspicion is based on privileged information and legal professional privilege is not excluded by the crime/fraud exception. It is the Law Society's view that you will have a reasonable excuse for not making an authorised disclosure and will not commit a money laundering offence."
Ultimately the circumstances in which a legal adviser in England & Wales might be required to disclose privileged documents to the other side in litigation, or to a public authority, remain extremely narrow. The courts are keen to maintain the protection of LPP, which is founded on important public policy principles. However there are specific exceptions to this position provided for both by statute or where communications fall within the crime/fraud exception. The Courts also appear keen to confine privilege to lawyers. However, there may be an interesting debate in the future as to whether accountants or lawyers advising on tax issues might have failed to comply with POCA if it is subsequently found that their client has committee unlawful tax evasion.

Edwards Wildman Palmer UK LLP
15 March 2013

A lawyer's obligation to safeguard confidential client information under U.S. law

By J. Christopher Jensen

J. Christopher Jensen is a partner and a commercial litigator in Cowan, Liebowitz & Latman, P.C and assisted with this article as a Volunteer Attorney for the International Senior Lawyers Project.

A. The Legal Framework for Protection of Confidential Client Information

In the United States, a lawyer's duty to safeguard the confidentiality of client information is primarily based upon rules governing the ethical conduct of lawyers. Rule 6.1(a) of the American Bar Association Model Rules of Professional Conduct, that has been adopted with some modifications in most jurisdictions in the United States, provides:

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosobligation ure is permitted by paragraph (b).

...upon rules governing the ethical conduct of lawyers.

The exceptions to this ethical obligation not to reveal client confidential information are set forth in Rule 1.6

(b): A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;

(6) to comply with other law or a court order; or

(7) to detect and resolve conflicts of interest arising from the lawyer's change of employment or from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client.

Section 6.1(c) obligates the lawyer to make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

These ethical rules impose both a negative duty not to use or to disclose confidential client information and an affirmative duty to safeguard confidential client information in the client's interest.

In addition to these ethical rules, the disclosure of confidential attorney-client communications and of attorney work product are privileged from disclosure in legal proceedings in all jurisdictions in the United States.

The attorney-client privilege protects from disclosure any communications made between privileged persons in confidence for the purpose of obtaining or providing legal assistance for the client. Restatement 3rd, Law Governing Lawyers, §68. This privilege evolved from English common law in which the English courts were reluctant to require lawyers to breach the code of a gentleman by being compelled to disclose what their clients had communicated to them in confidence.

The attorney-client privilege does not apply to all confidential client information in the possession of a lawyer.

The modern American privilege belongs to the client, not the lawyer, and the client has primary authority to determine whether to waive the privilege. The rationale for the privilege is that confidentiality is necessary because an honest and open discussion between the lawyer and his client is required for the lawyer to provide adequate legal assistance.

When the client is a corporation or other legally recognized organization, the attorney-client privilege extends to confidential communications between the lawyer and agents of the organization who reasonably need to know of the communication in order to act for the organization. Some courts in the United States have applied a "control group" test to determine who is covered by the privilege. Under this test, the privilege is limited to communications from persons in the organization who have the authority to control organizational policy and to take action under the lawyer's advice.

The U.S. law governing attorney-client privilege and the waiver of this privilege is complex and is beyond the scope of this discussion. In some circumstances, the attorney-client privilege can implicate rights guaranteed to U.S. citizens under the United States Constitution. This occurs primarily in the context of criminal defense where the confidentiality of attorney-client communications may be protected by the Constitutional privilege against self-incrimination under the Fifth Amendment and the right to effective assistance of counsel under the Sixth Amendment to the Constitution.

The attorney-client privilege only protects confidential communications between the lawyer and his client for the purpose of obtaining or providing legal advice. The attorney-client privilege does not apply to all confidential client information in the possession of a lawyer. Client documents or other client information in the possession of the lawyer are not subject to this privilege against disclosure unless the content meets the definition of an attorney client communication.

The laws of evidence and civil procedure in the United States also recognize a privilege against disclosing attorney work product. The work product privilege is intended to protect against the disclosure of the lawyer's thoughts and mental impressions rather than the confidentiality of client information per se.

B. The Exceptions to Confidentiality

Under the exceptions in ABA Model Rule 6.1(b), a lawyer may use or to disclose confidential information when required by law after the lawyer takes reasonably appropriate steps to assert that the information is privileged or otherwise protected against disclosure. If a lawyer receives a subpoena or judicial request for confidential client information, the lawyer must raise any reasonably tenable objections to another's attempt to obtain confidential client information if the disclosure would disadvantage the client and the client has not consented. If it is determined by the court the information is not privileged and disclosure is legally required, a lawyer's ethical duty not to use or disclose confidential client information is superseded under ABA Rule 1.6(b)(6) or its local equivalent.

A lawyer is also permitted, with some local variations, to use or disclose confidential client information when the lawyer reasonably believes its use or disclosure is necessary to prevent reasonably certain death or serious bodily harm to a person or is necessary to prevent a crime or fraud that threatens substantial financial loss. See ABA Rule 1.6(b)(1) and (2). Some jurisdictions in the United States have adopted an earlier, more restrictive rule that only permits disclosure where the lawyer believes the client's criminal act is likely to result in imminent death or bodily harm. Over 40 states have now adopted the more recent version of the ABA Model Rule 1.6(b)(2) that permits disclosure to prevent substantial financial injury.

Seventeen states also permit disclosure to rectify past and completed financial fraud and a few states even mandate lawyer disclosure in at least some circumstances of client fraud. This is contrary to the more generally accepted rule that only permits the lawyer's disclosure to prevent future or continuing fraudulent or criminal conduct and protects the lawyer's knowledge or information regarding the client's past conduct as privileged.

The U.S. Internal Revenue Code provides statutory authority for the Internal Revenue Service to issue summonses to ascertain the correctness of any tax return...

Before using or disclosing information under these exceptions, the lawyer must, if feasible, make a good faith effort to persuade the client not to act. If the client has already acted, the lawyer must advise the client to warn the victim or to take other action to prevent, rectify or mitigate the harm. The lawyer must also advise the client of the lawyer's ability to use or disclose the information.

C. The Authority Of The U.S. Internal Revenue Service

The U.S. Internal Revenue Code provides statutory authority for the Internal Revenue Service to issue summonses to ascertain the correctness of any tax return, to make a substitute return where none has been filed, or determine the liability of any person for any internal revenue tax. Section 7602 of the Internal Revenue Code specifically authorizes the IRS to issue three types of summonses: (1) a summons for books records, and other documentary data, (2) a summons for the testimony of the person concerned; and (3) a summons for the testimony of third parties.

The Internal Revenue summons is not self-enforcing. If the taxpayer or a third party fails to respond to the summons, the IRS must seek an order from a federal District Court of competent jurisdiction compelling the summoned party to respond. To obtain such an order, the IRS must establish that the investigation will be conducted for a legitimate purpose, the inquiry may be relevant to that purpose, the information sought is not already in the IRS possession and the administrative procedures required by the Internal Revenue Code for issuance of a subpoena have been followed. A judicial order directing compliance with the summons can be appealed to the appropriate Circuit Court of appeals.

If the IRS has already referred the matter to the United States Justice Department for criminal investigation, it may not issue a summons. In such a case, the Justice Department has the power to issue grand jury subpoenas or other requests for information under its criminal investigatory authority.
The state and local taxing authorities typically have similar authority under state law to subpoena and compel the production of taxpayer information.

Under the ethics rules describe above, a lawyer cannot ethically disclose the sources of funds which he has deposited in his client trust account unless the client consents to this disclosure. Nevertheless, a lawyer must comply with an IRS summons or similar legal process unless he determines that a meritorious objection may be made to the summons. If the lawyer determines that the disclosure of the information may not be compelled because of attorney-client privilege, for example, the attorney is ethically obligated to object to the summons in appropriate judicial proceedings and to disclose such information only when ordered to do so by the court.

...become more difficult in recent years for a taxpayer to resist disclosure of its identity...

The extent of the attorney-client privilege in tax investigations is a complicated subject and the judicial standards for such disclosure are not clear. In the wake of the recent financial scandals in the United States, the Internal Revenue Service has been more aggressive in using its summons power to obtain information from fraudulent tax planners. The courts have responded by increasingly narrowing the scope of the attorney-client privilege in the tax context. Several courts have recently found, for example, that the attorney-client privilege does not apply to communications surrounding the preparation of a client's tax return. Some of these courts have seen tax return preparation as an accounting or business service rather than legal advice. Other courts have found that because a completed tax return was intended for the IRS, information used in its preparation cannot have been made in confidence and is therefore not privileged.

The IRS has successfully challenged the argument made by tax shelter promoters that the participating taxpayer's identity is protected by attorney-client privileged. The courts rarely regard a client's identity to be privileged because it is not considered to be a communication, one of the required elements for attorney-client privilege. There may be circumstances, however, where the courts will uphold a privilege if a communication has already been disclosed and the client's identity will be the last link in the chain of identifying the otherwise privileged communication.

The Government can overcome the privilege under the crime-fraud exception discussed above if it can show the client was engaged in criminal or fraudulent conduct when he sought the advice of counsel, that he was planning such conduct when he communicated with his lawyer, or that he committed a crime or fraud subsequent to receiving the benefit of his lawyer's advice. Then the Government must also demonstrate the attorney's assistance was obtained in furtherance of the criminal or fraudulent activity. The courts will often determine whether the Government has made the required showings by its own "in camera" (without the presence of the attorneys) review of the attorney-client material. The crime-fraud exception is not typically invoked by the IRS itself to justify disclosing otherwise privileged communications but is increasingly being used by federal and state prosecutors in criminal tax investigations and prosecutions.

The extent of the attorney-client privilege in tax investigations is still the subject of some controversy and debate in the United States. There is little doubt, however, that it has become more difficult in recent years for a taxpayer to resist disclosure of its identity or other confidential information in the possession of its lawyer.

Publish What You Pay Norway is the Norwegian chapter of a global network of more than 650 organisations from over 70 resource rich countries. We work to establish financial transparency and accountability in the extractive sector, so that countries can mobilise their own capital to promote a sustainable future, democracy, and human rights.

Publish What You Pay Norway
Brugata 1
0186 Oslo
Norway

post@publishwhatyoupay.no
www.publishwhatyoupay.no

ISBN 978-82-93212-07-2

Publish What You Pay Norge © 2013