



**THE HISTORY OF LEGAL PROFESSIONAL PRIVILEGE AND ITS
ROLE IN TAX ADVICE
BY TAX PROFESSIONALS.**

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Abstract

This paper contends that the **taxpayers' right to confidentiality** plays a pivotal role in enabling taxpayers to be candid in consultations with their tax adviser, and that this right should attract equal protection notwithstanding the professional classification of the tax adviser. The emphasis is on balancing the revenue authorities' power to enable the collection of necessary revenue as efficiently and equitably as possible with the need to protect the taxpayer from unnecessary intrusion.

The paper outlines the historical development of **legal professional privilege**, from the Elizabethan concept of confidentiality to the traditional privilege as the right of the client in a complex legal system. A number of rationales for the privilege are discussed and the applicability of the rationales to tax accountants is explored. Finally it outlines the current state of play of legal professional privilege in the tax arenas of Australia, Canada, New Zealand, the United Kingdom and the United States of America.

Introduction

The rights to privacy, to confidentiality, of access to information, and to appeal against decisions of the administration, for example, are fundamental rights in democratic societies.¹ The paper concentrates on taxpayers' right to confidentiality and its pivotal role in enabling taxpayers to be candid in consultations with their tax adviser. Tax practitioners come largely from two distinct professions, the accounting profession and the legal profession². The tax discipline is neither pure accounting nor pure law. The tax practitioner's work can be divided into three main functions, tax preparation, representing clients in controversy with revenue authorities, and tax planning. All three functions rely to varying degrees on legal and accounting skills.

It is commonly acknowledged that tax legislation is extremely complex. The self-assessment tax system requires the taxpayer to interpret and apply the law.³ This coupled with the fact that in most instances the onus of proof is on the taxpayer has meant that the overwhelming majority of taxpayers turn to tax practitioners for assistance.⁴ A self-assessment system is heavily reliant upon voluntary compliance. Tax practitioners exert a strong and direct influence on level of tax compliance and ethical standards of their clients. Taxpayers need to be able to have full and frank discussions with their adviser about alternative courses of action, and seek guidance on future action. Generally, taxpayers seek to protect from compelled disclosure the thought processes, opinions and analyses of their advisers.

Taxpayers who consult tax lawyers enjoy the protection extended to confidential communications by legal professional privilege, and also the lawyers' duty to maintain confidentiality. Legal professional privilege protects communications from compelled disclosure, while the professional's duty of confidentiality protects communications from voluntary disclosure by the professional. Legal professional privilege belongs to the client, the client has the right to claim the privilege or waive the privilege. The duty of confidentiality relies on the professional to uphold the ethical value, though the client may have an equitable remedy in breach of confidence, along with injunctions against the use of the confidential information. The two professions - accountants and lawyers, have distinct professional codes, which influence the degree of protection afforded to confidential communications and the stance taken by the professional towards the revenue authority. This paper contends that the protection of taxpayers' confidential communications with their tax adviser should attract



equal protection notwithstanding the professional classification of the practitioner. Taxpayers' confidential communications need to be protected from compelled disclosure by the revenue authority, and this means that they need to attract legal professional privilege.

The traditional rationale for legal professional privilege

This section of the paper traces the historical development of legal professional privilege through the common law and discusses a number of rationales for the continued existence of privilege.

The traditional justification of legal professional privilege is that it promotes public interest in the administration of justice by ensuring effective legal representation.⁵ The law being a complex area the client needs to be encouraged to make full and frank disclosure to the legal adviser in order to secure effective representation in a court of law. There is a conflicting public interest that requires that, in the interest of a fair trial, litigation should be conducted on the footing that all relevant evidence is available. In *Grant v. Downs*, the conflict was expressed in the majority judgment of Stephen, Mason and Murphy JJ, in the following terms:

The rationale of this head of privilege, according to the traditional doctrine, is that it promotes the public interest because it assists and enhances the administration of justice by facilitating the representation of clients by legal advisers, the law being a complex and complicated discipline. This it does by keeping secret their communications, thereby inducing the client to retain the solicitor and seek his advice, and encouraging the client to make a full and frank disclosure of the relevant circumstances to the solicitor. The existence of the privilege reflects, the extent to which it is accorded, the paramountcy of this public interest over a more general public interest, that which requires that in the interests of a fair trial litigation should be conducted on the footing that all relevant documentary evidence is available.⁶

The special role of the lawyer in the adversarial system as protector of legal rights of parties, adviser, investigator, and consultant in deciding when and how to avoid litigation, may explain society's willingness to accept the privilege.⁷ However, a precautionary note from Hazard is in order:

There may be a sufficient justification for the privilege; indeed the verdict of our legal history is to that effect. But no argument of justification should ignore the fact that the attorney-client privilege, as far as it goes, is not only a principle of privacy, but also a device for cover-ups. That, of course, is what makes contemplation of it both interesting and troubling.⁸

Though legal professional privilege has general acceptance, its theoretical foundations may not be as sound as might first appear.

Weaknesses in the theoretical foundations of privilege law have prompted charges not only that privileges [privileged communications] are irrational and arbitrary, but also that they have been moulded principally by improper influences. Indeed, many evidence experts believe that the privileges serve no important societal purpose.^{9 10}

Traditional justification's applicability to tax accountants

Tax law is very complex and taxpayers require the assistance of professionals in order to be able to meet compliance requirements and structure their business transactions to minimise their taxes. The principle of tax minimisation is a legitimate goal for taxpayers. In the classic words of Judge Learned Hand:

Over and over again the courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced extractions, not voluntary contributions. To demand more in the name of morals is mere cant¹¹

The tax practitioner is required to abide by the revenue regulations while aiming to minimise the tax burden for their client. In balancing these obligations the tax practitioner encourages the client to comply with all the legal requirements while interpreting the requirements aggressively in favour of their client, when there is precedent or an arguable case for doing so.

If the emphasis is on enabling free and frank discussion between the taxpayer and practitioner, then the distinction between lawyer and accountant, in the tax arena, is difficult to uphold. Both professions provide similar services assisting clients in complying with their obligations, representing clients in disputes with the revenue authorities, and providing tax planning and advice. It is at the tax planning and advice stage that practitioners are able to assist clients in the creation of transactions and in making the facts. Facts that will affect the ease with which the client can meet their compliance requirements in the future and that can avoid controversy with the revenue authorities.

The problem faced by a taxpayer is that if he chooses to place his tax affairs in the hands of a practising lawyer then any communication of a confidential nature and any documents drawn up as a result of seeking advice, or in preparation for litigation will be privileged. While the taxpayer that chooses to act through an accountant may find that no such privilege attaches to confidential communications or documents.¹² On the other hand, where a taxpayer resolves not to make a decision without legal advice the taxpayer can appoint an accountant as an



agent for the purpose of instructing the lawyer and find that all confidential communications through the agent will be privileged.¹³

If the emphasis of the traditional justification is on lawyer-client privilege as an integral part of the proper administration of justice, then an argument for privilege being restricted to the legal practitioner can be made, by limiting the privilege to strictly 'legal' advice as opposed to tax or business advice. Thus avoiding the criticism of granting an unfair competitive advantage to the legal practitioner. However this argument itself may be criticised as being self-serving in that the legal profession has control over the decision making process, the judges makes the rules, and the rules made favour the legal profession.

Common law development of legal professional privilege

The doctrine of legal professional privilege was developed through the common law. An examination of the historical justification for the privilege reveals a closer connection between privilege and confidentiality than might appear from the traditional justification.

Elizabethan confidentiality

Elizabethan confidentiality existed to protect the honour and integrity of the gentleman, the holder of the confidential information.¹⁴ Lawyers were not distinguished from other gentlemen¹⁵ - all were protected by the notion of honour. The privilege belonged to the barrister, as a gentleman, and the courts recognised the right of gentlemen not to violate a pledge of secrecy. It was for the Barrister to decide whether to protect the communication by claiming privilege or to waive it. In England at this time the privilege was more readily granted to the Barrister than to a solicitor, an attorney or a scrivener. The Barrister as a presenter of evidence and argument was considered not merely an officer of the court, but a member of it. The solicitor, attorney or scrivener did not have such a high standing; they were men of business and servants of the family whose business and affairs they managed. There was an old and powerful sentiment that as servants they must keep the secrets of the master.¹⁶

The Roman precedent that the servant could not testify against his master is believed also to have influenced the principle of confidentiality.¹⁷

At Rome, the public policy which supported the privilege was directed against the corruption of the family (or quasi-family) relations which would result if the fullest confidence of the members was not

maintained. This policy was deemed superior to that which sought the correct settlement of controversies or the punishment of offenders, with the exception of treason.¹⁸

The history of legal professional privilege in English law can be traced to the reign of Elizabeth 1. Chief Baron Gilbert's early statement of the privilege was thus:

A Man retained as Attorney, Counsel or Solicitor can't give Evidence of any thing imparted after the Retainer, for after the Retainer they are considered as the same Person with their Clients and are trusted with their Secrets, which without a Breach of Trust cannot be revealed, and without such sort of Confidence there could be no Trust or Dependence on any Man, or no transacting of Affairs by the Ministry or Mediation of another, and therefore the Law in this case maintains such sort of Confidence inviolable.¹⁹

The recognition of privilege was slow and halting until after 1800.²⁰

Privilege as a rule of evidence came to the fore with the universal duty to testify²¹ and the imposition of compulsory process to secure the testimony of witnesses in an open court, before a jury charged with evaluating the evidence. This duty to testify altered confidentiality. It was no longer dishonourable to for a person who had received confidential information to reveal such information when compelled by a court of law. Voluntary disclosure of confidential information was still viewed as dishonourable. As Wigmore explains it:

The judicial search for truth could not endure to be obstructed by a voluntary pledge of secrecy, nor was there any moral delinquency or public odium in breaking one's pledge of secrecy under force of law.²²

The judicial search for truth could no longer be obstructed by voluntary pledges of secrecy, yet lawyers were to be treated differently, the judges decided that legal communications formed a special category because of the importance of obtaining legal advice. Legal professional privilege developed to protect legal communications from compelled disclosure.

Judicial Extension of Legal Professional Privilege

The transition of legal professional privilege from being the privilege of the lawyer, akin to confidentiality, to being the privilege of the client, with the aim of protecting legal communications from compelled disclosure was a slow progress that occupied more than one hundred years of English legal history. It was reasoned that the client needed the guarantee of non-disclosure in order that he may be encouraged to confide fully in the lawyer and by so doing he would receive the best and most appropriate advice.²³ The privilege was at this time still limited to litigation, actual or prospective.



The extension to cover communications where the client was seeking legal advice took place after much travail and turmoil over the period of half a century.²⁴ *Greenough v. Gaskell*²⁵ established the immunity of the attorney from compulsion to testify to communications concerning legal advice where there was no dispute and no prospect of litigation. Lord Brougham²⁶ stated:

If, touching matters that come within the ordinary scope of professional employment, they [legal advisers] receive a communication in their professional capacity, either from a client or on his account, and for his benefit in the transaction of his business, or, which amounts to the same thing, if they commit to paper, in the course of their employment on his behalf, matters which they know only through their professional relation to the client, they are not only justified in withholding such matters, but bound to withhold them, and will not be compelled to disclose the information or produce the papers in any court of law or equity, either as a party or as a witness.²⁷

Extending the same immunity from disclosure, to the client developed slowly and was finally settled in the decision of *Minet v Morgan*.²⁸ Both the lawyer and the client had immunity from disclosure of confidential communications.

The privilege was further extended to communications between lawyer and client and a third party made for the purpose of giving or obtaining legal advice in relation to anticipated litigation. The rationale being, that in order for legal representation to function effectively a lawyer cannot be compelled to disclose information given to him by third parties which relates to contemplated litigation. James LJ summed up the position succinctly in *Anderson v. Bank of British Columbia*²⁹ "...as you have no right to see your adversary's brief, you have no right to see that which comes into existence merely as the materials for the brief."³⁰

Judicial Limitations on Privilege

After 1833 the courts were careful to ensure that privilege was kept within justifiable limits and was tailored carefully to fit the needs of the society in which it sought to administer justice. That legal professional privilege was critical to the lawyers' role was by now well established the problem was and continues to be what limitations should apply. The purpose of legal privilege is to protect *bona fide* communications. Thus the first major and necessary limitation was to exclude from protection communications for an illegal purpose, and gradually the courts sought to confine privilege to legal advice. *R. v Cox & Railton*³¹ highlights the point, in the words of Stephen J who gave the judgement of the court,

In order that the rule [legal professional privilege] may apply there must be both professional confidence and professional employment, but if the client has a criminal object in view in his communications with his solicitor one of these elements must necessarily be absent.³²

There are two main reasons for denying privilege to communications where the client's intention is to further a crime or fraud. The first focuses on the client, since the client is aware of the criminal intent then no argument can be made for legitimate expectation that such communications would be protected. The second focuses on the legal adviser, it would be most unreasonable if a lawyer could not give evidence against a client if it subsequently transpired that the client had sought advice for a fraudulent or criminal purpose.³³

The courts established, at the beginning of the 1900's, that in order for the exception to apply to a communication, there must be more than a mere allegation of a crime or fraud: there had to be a strong prima case.³⁴ O'Connor J. citing *R. v Cox & Railton*³⁵ and *Bullivant v Attorney-General for Victoria*³⁶ with approval, stated:

The result of these authorities I take to be this, that the privilege will not be lost unless in the course of proceeding in which the evidence is tendered it is definitely charged that the communication was in itself a step in the commission of a crime or preparatory to or in aid of the commission of a crime.³⁷

Privilege as an Absolute right

From its inception the judicial approach to legal professional privilege was that the protection of communications between lawyer and client had a higher priority than the competing interest that the court should receive all relevant evidence. As Knight Bruce LJ explained in *Pearse v. Pearse*:³⁸

And surely the meanness and the mischief of prying into a man's confidential consultations with his legal adviser ...which must take place, and which, unless in a condition of perfect security, must take place, uselessly or worse, are too great a price to pay for truth itself.

The courts have consistently applied legal professional privilege as an absolute right. If the communication were deemed within the parameters for protection, the judge would not order disclosure, even if he perceived the operation to be unfair in a particular case. In *Williams v. Quebrada Railway Co.*³⁹ Kekewich J explained: "...it may be right that justice in [an individual] case should be defeated in order to uphold the general administration of justice." The privilege itself was deemed to be the result of the balancing exercise. Balancing the court's right to have all relevant information and the client's right to freely communicate with



his lawyer in the knowledge that confidential communications cannot be subject to compulsory disclosure.

Academic comment is overwhelmingly in support of the maintenance of absolute privilege on the basis that it provides procedural fairness and that it is most likely to produce results that are perceived to be just. One of the major proponents is Albert Alschuler who asserts:

From my perspective, the critical issue in assessing the attorney-client privilege and the obligation of confidentiality is not at all empirical. It is whether a client should be entitled to "rely on his attorney without question or doubt"⁴⁰ and whether he should "know as well as he is likely ever to know the future that giving the truth to his attorney will not hurt him."⁴¹ Forsaking more consequential justifications for the attorney-client privilege and the duty of confidentiality, I would favour these venerable legal and ethical institutions even if it could be demonstrated that most clients would tell their lawyers the truth without them.⁴²

A privilege subject to the balancing of interests approach would make the law uncertain and would place an onerous burden on the judge. This is particularly relevant in the tax arena where often a balance needs to be struck between providing the revenue authority with enforcement powers that both coerce dishonest taxpayers and encourage conscientious taxpayers, while minimising the interference with individual liberty and privacy.

Academic approaches to legal professional privilege

Wigmore - The Utilitarian Approach

The utilitarianism's overriding moral principle, holds that the good consists of the promotion of the greatest happiness for the greatest number.⁴³ Utilitarianism is the predominant justification for privilege, and it justifies or rejects a specific privilege by balancing the utility of the privilege against the costs of the privilege to the litigation. Wigmore in his treatise on evidence sought to codify and the law of evidence. Wigmore established four criteria as prerequisites to the existence of any privilege protecting confidential communications, and unless the criteria are met there neither is nor ought to be a privilege.⁴⁴

- (1) The communications must originate in a *confidence* that they will not be disclosed.
- (2) This element of *confidentiality must be essential* to the full and satisfactory maintenance of the relation between the parties
- (3) The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*.

- (4) The *injury* that would inure to the relation by the disclosure of the communications must be *greater than the benefit* thereby gained for the correct disposal of litigation.⁴⁵

Wigmore's formulation is utilitarian in nature, asserting that communications made within a given relation should be privileged only if the benefit derived from protecting the relation outweighs the detrimental effect of the privilege on the search for truth. This formulation itself invites the courts to perform a balancing act. Wigmore, who favours the privilege, acknowledges that "[I]ts benefits are all indirect and speculative; its obstruction is concrete"⁴⁶ Rosenfeld states the case thus:

Accordingly, utilitarian theory could justify the preservation of the attorney-client privilege despite its shortcomings. Although the privilege has a harmful consequence of the concealment of otherwise relevant information, this consequence is outweighed by the benefits of the assertion of a greater number of just claims and the more effective presentation made possible by uninhibited attorney-client consultations.⁴⁷

As a strong believer in the duty to testify, Wigmore constricted the recognition of privileges to the traditional privileges, and was not in favour of creating new ones⁴⁸.

Applying Wigmore's Analysis to Tax Accountants

Wigmore cautioned against the extensive use of privileged communications. Courts in determining where the privilege should apply often cite the four fundamental conditions that Wigmore stated as necessary to the establishment of a privilege. The Wigmore formula is concerned with the nature of the communications and the importance of maintaining the relationship involved from society's point of view.

In contrast to these tests, the courts have based the applicability of privilege primarily on the *communicators* involved and their respective titles,⁴⁹ i.e. is he an attorney, client, doctor, accountant? This arbitrary test in no way harmonizes with the Wigmore standard.⁵⁰

That communications between a taxpayer and a tax accountant could be confidential in nature would not be difficult to establish. The information that is to be conveyed to the revenue authority cannot meet this confidentiality argument, however discussions about the tax consequences of completed or prospective transactions are confidential in nature. Confidentiality is central to the relationship if sensitive financial issues are to be fully explored and structured to comply with the law, while minimising taxes. That the relationship is one of importance to the community can also be easily established, given the complexity of the law and the burden on taxpayers in a self -assessment system.



A balance needs to be struck between taxpayer's right to confidentiality and the revenue authority's ability to access information so that it can collect the necessary revenue as efficiently and equitably as possible. Generally revenue authorities have broad investigative and compulsory disclosure powers. The accounting records, documents implementing transactions and information upon which the return is based, are and should be easily accessible by the revenue authority. The harm to the relationship between the taxpayer and the tax accountant needs to be weighed against the harm to the revenue authority in impeding its access to all relevant information. The tax return is the primary source of information for the revenue authority, and what the taxpayer seeks to protect is the thought processes and advice of the tax accountant.

Wigmore's criteria do not explain the existence of a privilege, because both privileged relationships and relationships unprivileged elsewhere meet their standards. But even if they were to be accepted as the explanation of the attorney-client privilege, they still would not justify it: they give neither reason nor even hit of a reason why the legal profession is given a privilege but other groups meeting the tests are not.⁵¹

Modern Approaches to Privilege

Legal professional privilege creates information

In weighing the costs and benefits of privilege, the loss of relevant information to the courts is deemed to be the most crucial. Yet the very purpose of privilege is to enable full and frank discussion, privilege serves to create information that did not exist before and might not exist otherwise. To the extent that privilege is necessary to promoting frank disclosures by the client, it cannot be deemed to impede the search for truth. Therefore the presumption of loss of evidence may be more imagined than real. Saltzburg argues:

In dealing with privilege claims the courts should focus on the ex ante issue: To what extent will the privilege promote the creation of information that might otherwise not exist? If the court focuses only on the ex post question- i.e., after information already has been created, what are the respective harms in a particular case of disclosure and nondisclosure - the court ignores the crucial aspect of privileges, which is the promoting of information-sharing and experimentation in the future, when others will think about whether to assist in the creation of information.⁵²

The point is that at least some evidence exists only because a privilege exists, and it is also likely that the more incriminating the evidence, the less likely it would be that a person would reveal it in the absence of privilege. This incriminating evidence is likely to be most valuable, and this would tend to tip the scales in preference of privilege.⁵³ If the effect of withdrawing or limiting the privilege were merely to cause a client to withhold his confidences, the

effectiveness of the lawyer's representation might be impaired while the search for truth would not be advanced in the slightest.⁵⁴ In the tax arena full and frank communications are vital to the provision of effective tax advice.

The claim that privilege encourages communications has been criticised on empirical grounds. Critics assert that generally the public is unaware of the privilege and question that even if they did have knowledge of it, such knowledge would rarely affect their communicative behaviour.⁵⁵ There are few empirical studies⁵⁶ on the knowledge of, and the communicative affects of privilege. A study conducted by Yale Law Journal⁵⁷ of judges, lawyers, accountants, marriage counsellors, psychiatrists, psychologists, social workers and laymen on their attitudes and practices regarding the privileged communications rule, resulted in some interesting findings. Lawyers significantly more than laymen, believe the privilege encourages free disclosure to them.⁵⁸ The survey results also indicated that lawyers, more than laymen oppose the extension of privilege to other professions.⁵⁹ This study showed that many people are unaware of the privilege, however the relevant point may be whether those who know of the privilege would become aware of (and act on) its absence.⁶⁰ People involved in litigation may be more concerned with secrecy, and may educate themselves about privilege.⁶¹ People involved in discussing sensitive issues,⁶² such as financial issues, that could have legal consequences may also be more concerned about privilege.⁶³ Professionals are also known to inform clients of the protected status of their confidential communications. Professionals more likely to be aware of the privileged status of their communications, and are likely to have professional codes of ethics that require confidentiality. However, if their communications can be subject to compelled disclosure then they may find a conflict between their duty to obtain all relevant information from clients, and their duty to testify before a court. The result may be a drying up of information and professionals failing in their duty to assist the client in discovering all the facts and the ramifications of completed actions or proposed actions. In the tax arena this may extend to tax accountants deliberately not asking otherwise pertinent questions for fear of being forced to disclose the facts upon interrogation by the revenue authority.

The Right to Privacy Rationale

This privacy rationale focuses on the protection the privilege affords to an individual's privacy, as opposed to the utilitarian emphasis on societal benefits. The privacy rationale views limitations to privileges protecting confidential communications as invasions of



privacy. However, not all invasions of privacy are necessarily evil, the privacy interest must always be balanced against society's interest in ascertaining the truth.⁶⁴ This privacy rationale is an argument for courts to exercise discretion and to protect confidential communications from compelled disclosure where they assess that the harm to the relationship is greater than that suffered by the court in its search for truth.

The adversary system is structured like Adam Smith's economic world. Individual litigants each pursue their own self-interest before a disinterested judge or jury, who play a role akin to the 'invisible hand' in Adam Smith's marketplace.⁶⁵ Truth is revealed as the litigants are motivated by their desire for victory. To be meaningful, the individual litigant's right to seek victory must entail both access to relevant information and the ability to protect confidential communications.

The privilege creates a zone of privacy in which the client and the adviser can create information and explore future actions. The essence of the right to privacy is control over information about oneself not total secrecy. Rejection of a claim of privilege destroys the claimant's control over the audience who receives the information, the timing of the release of information, and the conditions under which the information is released. Privacy both protects private citizens from state control and permits full development of their public selves.⁶⁶

Once care is taken to analyse the concept of privacy, its relationship to personal testimonial privileges is quite striking. ...Most important, however, is the simple fact that when a particular confidant's claim of privilege is upheld, so is his very right of privacy. That society cannot protect against all abridgments of that right makes it more, not less, imperative that privacy be preserved whenever possible. ...In short, our security and privacy is enriched substantially when a testimonial privilege, properly invoked, is given societal approval.⁶⁷

Compelled disclosure offends the individual's right to control the distribution of personal information, and offends the right of individuals to form private loyalties. When the compelled disclosure is directed at the client, the client suffers the harm of shame, and when it is directed at the adviser, the adviser either commits treachery⁶⁸ or suffers the harm of lying. Thus compelled disclosure harms both the parties.

The current state of play: legal professional privilege in the tax arena:

Legislative provisions

The doctrine of legal professional privilege was developed through the common law. However there are a number of key issues that have been addressed by the legislature and have altered the operation of privilege. For example, the United Kingdom the *Police and Criminal Evidence Act* (1984) section 8 specifically excluded items subject to legal professional privilege from powers of search and seizure.

In the tax arena the legislation has in some jurisdictions specifically recognised the role of privilege for tax advisers. In Canada⁶⁹ and New Zealand⁷⁰ the revenue legislation provides for legal professional privilege but is silent on accountant-client confidentiality. In the United States *Internal Revenue Code* (1954) is silent on privilege, however the *Internal Revenue Restructuring and Reform Act* (1998) extend, with some notable exceptions⁷¹, the attorney-client privilege to confidential communications between clients and their Federally Authorized Tax Practitioners. In Australia the *Income Tax and Assessment Act* (1936) is silent on legal professional privilege and accountant-client confidentiality. In the United Kingdom the *Tax Management Act* (1970) enables a legal adviser to claim privilege⁷² and extends a similar privilege to tax accountants.⁷³ The *Act* also protects from compelled disclosure the working papers of statutorily appointed auditors.⁷⁴

The recent decision in the United Kingdom by the Court of Appeal in *R (on the application of Morgan Grenfell' & Co. Ltd) v Special Commissioner*⁷⁵ concluded that section 20(1) of the *Tax Management Act* (1970) authorises an Inspector to issue a notice requiring disclosure by a taxpayer of privileged material. The Court of Appeal agreed with the Divisional Court's⁷⁶ interpretation that the provisions of the code carry the inescapable implication that the rule of legal professional privilege is excluded except where it is expressly preserved and that the provisions in the code which make express provision for documents which need not be produced mark the limits of the available exceptions.⁷⁷ The question remains to whom does the privilege belong? The curious result of this case is that the Revenue can obtain from the taxpayer privileged communications that are protected from disclosure when in the hands of the legal adviser. The outcome is comparable to the Australian High Court decision in *Yuill*⁷⁸, which held that in so far as 'special investigations' conducted under the authority of Australia's federal company law were concerned, legal professional privilege serves to protect only the legal practitioner from breach of the privilege. The client can in turn be required to disclose confidential information to investigating officers.



More damaging for the operation of legal professional privilege is the recent decision of the Full Federal Court of Australia in *Australian Competition and Consumer Commission v. The Daniels Corporation International Pty Ltd.*⁷⁹ The Court held that the claim of legal professional privilege is not a valid answer to a notice under Australia's anti-trust and consumer protection law. Therefore a client served with such a notice is not entitled to refuse compliance on the ground of legal professional privilege, and the solicitors served with such a notice cannot do so on the ground that they owe their client a duty to protect the client's privilege: they can be in no better position than their client. Both the law firm and the Company have indicated that they will seek special leave to appeal to the High Court.⁸⁰

Australian case law

Sections 263 or 264 of the Australian Income Tax Assessment Act do not expressly abrogate legal professional privilege. However the question of whether they do so *implicitly* has been addressed by the courts in a number of federal and high court judgments, culminating in the decision of the Full Court of the High Court in *Baker v Campbell*.⁸¹ The Court held that in the absence of a clear expression of legislative intent to the contrary, search warrants do not authorise the violation of legal professional privilege. Furthermore the principle operates beyond the *curial* context, to investigative contexts where there is not, as yet, any question of admissibility of evidence.

In the tax arena the Full Federal Court in *Commissioner of T v Citibank Ltd* (1989)⁸² stressed that a third party holding documents on behalf of clients must be allowed to protect the privileged status of those documents. In the light of the *Citibank Ltd.* case professionals such as solicitors and accountants in possession of clients' documents even as gratuitous bailee must ensure that rights arising from legal professional privilege are preserved and protected. They must take steps to protect such documents in their possession from unwarranted disclosure or seizure. The High Court decision in *Yuill*⁸³ casts doubt on the *Citibank* decision. Hill J has expressed the view that *Yuill* maybe applicable to section 263 of the Income Tax Assessment Act

...there would seem to be much to be said, at least in the context of s 263, for the view that the absolutist language of the section and the purpose which it has in the Act provide the necessary implication that legal professional privilege is overborne.⁸⁴

Justice Hill went on to point out that the *Citibank* case did not consider the policy issues involved and they proceeded on the basis that there was no difference between a statute of general application such as the Crimes Act and the more specific Income Tax Assessment Act. Furthermore the Commissioner of Taxation did not present any argument for the ousting of legal professional privilege. Until the High Court directly considers the question of whether sections 263 and/or 264 of the Income Tax Assessment Act abrogate legal professional privilege, some doubt will remain as to whether the sections are subject to legal professional privilege.

Continued evolution of privilege?

Legal professional privilege has evolved through the common law. Whether the privilege will in future extend to other professions is doubtful. However a number of writers including Professor Les Nethercott and Skinner J suggest that it may. As they note:

Like other aspects of the law, the concept of legal professional privilege has evolved. Consequently, it may be argued that there is no reason why it should not evolve to the stage where clients of suitably qualified accountants are accorded the same privileges as clients of solicitors. ...There are a number of currently existing situations in which it would seem that accounts have an obligation to ensure that a client's right to privilege is not lost.⁸⁵

The common law has been generally consistent in limiting privilege to the legal profession. Any significant change is more likely to come about by legislation, indeed in the United States⁸⁶ and the United Kingdom⁸⁷ the *limited* extension of privilege to tax accountants was provided for in legislation. Whereas an overwhelming number of court decisions sought to distinguish between 'legal' and 'accounting' services, in order to limit the privilege to 'legal' services. In the United States the recent controversial judgement in *Fredericks*⁸⁸ highlights the unsettled nature of privilege in the tax arena and flies in the face of Congress's attempt to provide taxpayers with expanded coverage.

Extension to tax accountants

Tax accountants can organise their working papers effectively to segregate tax advice from general accounting advice, and facilitate the operation of client privilege in the tax arena. This paper contends that client privilege should protect from compelled disclosure tax advice provided by an external tax accountant that directly concerns the rights and liabilities of the taxpayer. Protection is sought for the tax accountant's thought processes, notes, tax opinions, tax planning memoranda, analysis of what constitutes substantial legal



authority, discussions of contrary authority, risk assessment, interviews, statements, memoranda, correspondence, briefs and mental impressions in preparation for litigation.

In essence the external tax accountant providing tax advice in the process of assisting a taxpayer to meet compliance requirements; or defending a taxpayer in dispute with a revenue authority; or engaged in legitimate tax planning should be able engage in full and frank discussions in the knowledge that confidential communications will enjoy the protection of client privilege. Tax accountants are not licensed to practice in criminal cases hence the protection sought by client privilege is limited to civil disputes.

It is beyond the scope of this paper to argue for a general accountant-client privilege.⁸⁹ The role of the auditor is the foundation of the accounting profession, and in this role the emphasis on the accountant's duty to the public is greater than any duty to the client. The United States Supreme Court in *United States v. Arthur Young & Co*⁹⁰ stressed that an accountant in certifying the public reports of a corporation assumes a public responsibility that transcends any employment relationship with the client. It stresses that:

The "public watchdog" function demands that the accountant maintains total independence from the client at all times and requires complete fidelity to the public trust.⁹¹

The common law has restricted the operation of privilege to a narrow band of circumstances and client privilege should be similarly restricted in its application, the courts should be able to draw upon the judicial experience gained in dealing with legal professional privilege. Of particular importance in the tax arena are the crime/fraud exception, and the dominant purpose rule. Implicit in the privilege is the requirement that the communications were made for a lawful and proper purpose, thus privilege is denied when the communications are made to further an illegal act or fraud. Hence communications relating to tax evasion or other illegal schemes, would not enjoy privilege.

The dominant purpose rule is essentially that the communication was made for the dominant purpose of seeking or receiving advice, or for preparation for actual or anticipated litigation. Thus the seeking of tax advice or preparation for actual or anticipated litigation would have to be the dominant purpose of the communication, in order for privilege to apply. The distinction would need to be made between tax advice and general business advice.

The privilege belongs to the client, however where a client brings an action against the accountant and makes those very communications an issue before the court, fairness would dictate that the accountant should be able make disclosure in order to defend the allegations.

Client privilege should also protect from compelled disclosure by the revenue authority the audit work papers of an external auditor. Audit work papers are confidential documents that record the procedures undertaken by the auditor in producing an audit opinion. They are not a primary source of facts - they are a record of the auditor's opinion, assertions and assessment of the client's motives rather than facts. Auditors depend on the cooperation and openness of clients, in order to perform their audit, they have no power to require compulsory disclosure of information, and any threat of compelled disclosure of their papers could result in a chilling effect on communications by clients. Many in the accounting profession have argued that clients would reduce disclosures of sensitive tax information to their auditors if the revenue authority were able to routinely access audit work papers and that this would lead to less accurate financial statements. This argument was made by Arthur Young, with the support of the American Institute of Certified Public Accountants, in *U.S. v. Arthur Young and Co.*⁹² However the Supreme Court took an opposing view of auditor's powers and asserted that the costs of not obtaining an unqualified opinion exceed the benefit of not disclosing arguable tax return positions, thus concluding that revenue access would not reduce client candour or financial statement accuracy.⁹³

Conclusion

Legal professional privileged has evolved through the common law and it is now vastly different to the original Elizabethan concept of confidentiality. The courts are constantly highlighting that privilege is an essential component of the adversarial system, and that it should be contained within narrow limits. The essential question is whether privilege can be extended to accountants in the tax arena on the basis that accountants acting on behalf of their clients are often involved in an adversarial contest with the revenue authorities. And whether such an extension is consistent with the aim to contain privilege within carefully tailored limits to serve the society in which it operates. As society changes so too must privilege change and adapt to it. The courts have made many of the changes to privilege, and in other instances parliaments have legislated change. When privilege was being formulated in the



common law the accounting profession, did not have the standing and status that it has in modern society. In the tax arena it is often the tax accountant's advice to the taxpayer that is directly concerned with rights and liabilities enforceable in tax law.⁹⁴

Endnotes

- 1 Rights designated as fundamental rights in the OECD. OECD, 'Taxpayers' Rights and Obligations. A Survey of the Legal Situation in OECD Countries', (1990) 10.
- 2 The writer acknowledges that there are a number of tax practitioners with dual - legal and accounting - qualifications, but has decided to exclude this third group, in order to highlight the differences between the two professions.
- 3 The self assessment system has applied in Canada since 1917, and currently applies in Australia, New Zealand, the United Kingdom, and the United States.
- 4 In the U.S. tax practitioners file approximately sixty percent of all but the simplest returns. See Christensen A., 'Evaluation of Tax Services: A Client and Preparer Perspective' (Fall 1992) *The Journal of the American Taxation Association* 60. In Australia the figure is approximately seventy-two percent. See National Review of Standard for the Tax Profession: 1994 'Tax Services for the Public' (1994) Australian Government Publishing Service at xviii.
- 5 See *Grant v. Downs* (1976) 135 CLR 675.
- 6 *Id* 685 (Stephen, Mason, Murphy JJ).
- 7 See Louisell, D., 'Confidentiality, Conformity and Confusion: Privileges in Federal Court Today' (1956) 31 *Tul. L. Rev* 101, 110 "arguing the "[I]t is the historic judgment of the common law, as it... is generally in western society, that whatever handicapping of the adjudicatory process is caused by recognition of the privileges, it is not too great a price to pay for secrecy in certain communicative relations."
- 8 Hazard, G.C., 'An Historical Perspective on the Attorney-Client Privilege' (1978) 66 *California L Rev* 1061, 1062.
- 9 Krattenmaker, T.G., 'Testimonial Privileges in Federal Courts: An Alternative to the Proposed Federal Rules of Evidence' (1973) 62:61 *The Georgetown LJ* 61, 85. 'Perhaps the majority of evidence experts share the Advisory Committee's apparent perspective that testimonial privileges are mere bothersome exclusionary rules, born of competing professional jealousies, that impede the accuracy of fact finding and serve no other important societal goals.'
- 10 Note 'Developments in the Law Privileged communications' (1985) 98 *Harvard L Rev* 1450, 1471.
- 11 *Commissioner v. Newman*, 159 F 2nd 848
- 12 The United States the *Internal Revenue Restructuring and Reform Act* (1998) extends the attorney-client privilege to confidential communications between clients and their Federally Authorized Tax Practitioners. There are however some notable exceptions; the privilege does not apply in criminal cases, state taxes, corporate tax shelters and to communications between accountants and clients during tax-return preparation. In Australia the *Income Tax and Assessment Act* (1936) is silent on legal professional privilege and accountant-client confidentiality.
- 13 Reicher, H., 'What to do when the Commissioner Attacks; Preserving your Client's Sanity and Liquidity' (1979) *Tax Strategies for Advisors*, 1, 2.
- 14 See *Annesley v. Anglesea* (1743) 17 St. Tr. 1139.
- 15 Accountants would not in this period have been considered part of this elite group of gentlemen. 'The first full-time public account of whom we have knowledge was in Edinburgh during the last half of the 17th century. It was not until the latter part of the 19th century that accountants came under regulation in the United Kingdom or America.' (1957) *I Encyclopaedia Britannica* 103, 104.
- 16 Gardner, J. A., 'A Re-evaluation of the Attorney-Client Privilege.' (1963) vol .8 n.3 *Villanova L.Rev.* 279, 289.
- 17 *Id.* 290.
- 18 Radin, M., 'The Privilege of Confidential Communications between Lawyer and Client', (1928) 16 *California L Rev* 487 pp. 491-92.
- 19 Gilbert, G., (1754) *The Law Of Evidence* (Dublin) p. 98. This work a collection of Chief Baron Gilbert's notes was published nearly thirty year after his death in 1726. The common law applied to the barrister-client relationship as early as 1577 in *Berd v. Lovelace*, (1577) 21 Eng.

- Rep. 33; and to the Husband-wife relationship shortly afterwards in *Bent v. Allot* (1580) 21 Eng. Rep 50. In the words of Gilbert: "And it would be very hard that a Wife should be allowed as Evidence against her own Husband; such a Law would occasion implacable Divisions and Quarrels, and destroy the very legal Policy of Marriage that has so contriv'd it, that their interest should be but one; which it cou'd never be if Wives were admitted to destroy the Interest of their Husbands, and the Peace of Families cou'd not easily be maintained, if the Law admitted any Attestation against the Husband.' 98.
- 20 See Hazard, G.C., 'An Historical Perspective on the Attorney-Client Privilege' (1978) 66 *California L Rev* 1061
- 21 See *Act for Punishment of Such as Shall Procure or Commit Any Wilful Perjury*, 1562 and Cobbett's State Trials 769, 788 (1612) (speech of Sir Francis Bacon) ('[A]ll subjects, without distinction of degree, owe to the king tribute and service, not only of their deed and hand, but of their knowledge and discovery.') Prior to this "the party opponent in a jury trial was *not compellable to be a witness* seems unquestioned since the beginning of recorded trials" Wigmore, J. H., (1961) *A Treatise on the Anglo-American Law of Evidence* McNaughton Rev Edn., Little Brown, Boston ss2217 at 169 (hereafter cited as Wigmore)
- 22 *Ibid.* at 543
- 23 See *Greenough v. Gaskell* (1833) 1 My & K 98, 39 E R 618.
- 24 Gardner, J. A., 'A Re-evaluation of the Attorney-Client Privilege.' (1963) vol. 8 n. 3 *Villanova L Rev* 279, 295.
- 25 (1833) 1 My & K. 98, 39 Eng. Rep. 618.
- 26 See Hazard, G.C., 'An Historical Perspective on the Attorney-Client Privilege', (1978) 66 *California L Rev* 1061, pp.1083-6 wherein Lord Brougham is described as the author of this expansion of privilege, an expansion performed by manipulating and at times ignoring precedent, in particular *Annesley v. Anglesea*, and *Bolton v. Corporation of Liverpool* 1 Myl & K. 88, (Ch. 1833) 39 Eng. Rep 614.
- 27 (1833) 1 My & K 98, 102, 39 Eng. Rep. 618.
- 28 (1873) L R. 8 Ch. 361, 366.
- 29 (1876) 2 Ch. D. 644.
- 30 *Id.* 656.
- 31 (1884) 14 QBD 153
- 32 *Id.* 168.
- 33 Newbold, A.L.E., 'The Crime/Fraud Exception to Legal Professional privilege' (1990) 53 *The Modern L Rev*, 472, 475.
- 34 *Bullivant v. Attorney-General for Victoria* (1901) AC 196.
- 35 (1884) 14 QBD 153.
- 36 (1901) AC 196.
- 37 *Vanara v. Howard Smith & Co Ltd* (1910) 10 CLR 382, at 386
- 38 (1846) 1 Deb & Sm. 12, 63 ER 950
- 39 [1895] 2 Ch. 751
- 40 Alschuler, A. W., 'The Preservation of client's Confidences: One Value among Many or a Categorical Imperative?' 52 *University of Colorado L Rev* 349, 352.
- 41 *Id.* at 352
- 42 Alschuler, A. W., 'The Search for Truth Continued, the Privilege Retained: a Response to Judge Frankel' 54 *University of Colorado L Rev* 67, 73-4.
- 43 See generally Rosenfeld, M., 'Between Rights and Consequences: a Philosophical Inquiry into the Foundations of Legal Ethics in a Changing world of Securities Regulation' (1981) 49 *Washington L Rev* 462.
- 44 8 Wigmore s2285 at 257.
- 45 *Ibid.* (emphasis in original).
- 46 *Id.* s2291 at 557.
- 47 Rosenfeld, M., 'The Transformation of the Attorney-Client Privilege: In Search of an Ideological Reconciliation of Individualism, the Adversary System, and the Corporate Client's SEC Disclosure Obligation' (1982) 33 *The Hastings L J* 495, 508.

48 8 Wigmore s 2286 at 532-37. Wigmore concluded that the accountant-client relationship does
not merit the protection offered by testimonial privilege.

49 See *Garipey v. U.S.*, 189 F2nd 459 (6th cir 1951); *Olender v. U.S.*, 210 f 2D 795 (9TH Cir 1954)

50 Jentz, G.A., 'Accountant Privileged Communications: Is It a Dying Concept Under the New
Federal Rules of Evidence?' (1974) *American Business L J* 149, 151. (emphasis in original)

51 Notes and Comments, 'Functional Overlap Between the Lawyer and Other Professionals: its
Implications for the Privileged Communications Doctrine', (1962) 71 *Yale L J* 1226, 1231.

52 Saltzburg, S., 'Privileges and Professionals: Lawyers and Psychiatrists' (1980) 66 *Virginia L Rev*,
597, 600.

53 Note 'Developments in the Law Privileged communications' (1985) 98 *Harvard L Rev*, 1450,
1477.

54 Alschuler, A. W., 'The Preservation of client's Confidences: One Value among Many or a
Categorical Imperative?' 52 *University of Colorado L Rev* 349, 350. Alschuler adds; "In some
situations, however, the search for truth might be advanced because dishonest clients would
lie to their lawyers in ways that could be exposed with devastating effect at trial. Still, in other
instances, a lawyer who had been told the full truth might have found legitimate ways to
minimize the impact of embarrassing facts so that the privilege would have furthered the
search for truth."

55 See Krattenmaker, T.G., 'Testimonial Privileges in Federal Courts: An Alternative to the
Proposed Federal Rules of Evidence' (1973) 62:61 *The Georgetown L J*, 61, 91. Discussing the
marital privilege 'Nor is it deniable that much confidential disclosure does take place without
conscious thought of whether a legal privilege is available.'

56 See also Shuman & Weiner, 'The Privilege Study: an empirical examination of the
Psychotherapist-Patient Privilege, (1982) 60 *N C L Rev* 893.

57 See Notes and Comments, 'Functional Overlap Between the Lawyer and Other Professionals:
its Implications for the Privileged Communications Doctrine', (1962) 71 *Yale L J*, 1226. The
survey used four discrete sets of questionnaires one set for laymen, a second for the 'other'
professions, a third for lawyers and a fourth for judges.

58 *Id*, 1232. 72% of the lawyers surveyed had such a belief, 10% did not, and 18% did not know.
Laymen surveyed 51% said they would be less likely to make free disclosure to an attorney if
there was no privilege, 34% would not be, and 15% did not know. (raw data converted to
percentages.)

59 *Id* 1233 In reference to extending the privilege to accountants 61% of lawyers were opposed,
26% were in favour, and 13% did not know. While 44% of laymen were opposed, 36% were in
favour, and 20% did not know. At 1249. Since only 12 accountants participated in the survey
it would not be valid to generalise the finding. The 12 participates were evenly split on the
matter. (raw data converted to percentages.)

60 Reutlinger, 'Policy, Privacy, and Prerogatives: A Critical examination of the Proposed Federal
Rules of Evidence as They Affect Marital Privilege, (1973) 61 *Calif. L Rev* 1353, 1377-78

61 *Ibid*, 1377. Reutlinger argues that people most likely to need privileges are likely to be better
informed.

62 Singer, 'Informed Consent: Consequences for Response Rate and Response Quality in Social
Surveys' (1978) 43 *America Soc. Rev* 144, 150-1. An empirical study finding that people are
more likely to answer sensitive questions when assured of confidentiality.

63 Shuman & Weiner, 'The Privilege Study: an empirical examination of the Psychotherapist-
Patient Privilege, (1982) 60 *N C L Rev* 893, 919-20. The study found that although people
indicated no greater willingness to talk when they knew they had a privilege than when they
knew nothing about it, they did indicate a dramatically lower willingness to talk about
sensitive subjects with legal consequences once told that they had no privilege.

64 Most proponents of the privacy rationale agree that privacy must always be balanced against
other interests. Westin, A., *Privacy and Freedom* (1967) p 25 argues that society requires some
invasions of privacy.

65 Hazard, G., (1978) *Ethics in the Practice of Law* presents a picture of open competition in what
may be characterised as a "marketplace of ideas". pp. 122-23



66 Krattenmaker, T.G., 'Testimonial Privileges in Federal Courts: An Alternative to the Proposed
Federal Rules of Evidence' (1973) 62:61 *The Georgetown Law Journal* 61 p. 89
67 *Id.* pp. 89-92.
68 Wigmore in his response to the Bentham's attack acknowledged this treachery as an
impalpable but actual harm. S 2291 at 553.
69 Section 232 (1) (e) of the *Income Tax Act R.S.C* (1952) (Canada) defines solicitor-client privilege.
The section relates only to non-disclosure by the solicitor of privileged information, it does not
deal with documents found in the possession of a client or a third party, such as an
accountant; these questions are governed by the common law.
70 Section 20 of the *Tax Administration Act* (1994) gives legislative recognition to the claim of
privilege for confidential communications between legal practitioner and client it codifies the
common law doctrine.
71 The privilege does not apply in criminal cases, state taxes, corporate tax shelters and to
communication between accountants and clients during tax-return preparation. See section
3411 *Internal Revenue Restructuring and Reform Act* (1998)
72 See section 20B(8) *Tax Management Act* (1970).
73 See section 20B(9) *Tax Management Act* (1970).
74 See section 20B(9) *Tax Management Act* (1970).
75 [2001] All ER (D) 24 (2 March 2001)
76 [2000] All ER (D) 1729
77 The Court of Appeal also address the role of the *European Convention on Human Rights*
specifically Article 8(2) and concluded that the economic wellbeing of the country was in this
case a ground on which the right to respect for private life and correspondence might be
abrogated.
78 *Corporate Affairs Commission (NSW) Yuill & Ors* (1991) 172 CLR 319
79 [2001] FCA 244
80 Financial Review Friday 30th March 2001.
81 (1983) 153 CLR 52. The majority judgment of Murphy, Wilson, Deane, and Dawson JJ with
Gibbs CJ., Mason and Brennan JJ. dissenting.
82 20 FCR 403
83 *Corporate Affairs Commission (NSW) Yuill & Ors* (1991) 172 CLR 319
84 Justice DG Hill, "Income Tax Assessment Act 1936, Sections 263, 264' in Zariski A (Ed), 1993,
Evidence and Procedure in a Federation, The Law Book Company Ltd, Sydney, 212.
85 Professor Nethercott, L and Skinner J, "The Commissioner's Right to Information: Sec. 263'
(1990) *The CCH Journal of Australian Taxation* 40, 49.
86 *Internal Revenue Service Restructuring and Reform Act* (1998)
87 *Tax Management Act* (1970)
88 83 AFTR2d 99-1870
89 In the United States, nineteen states have incorporated courtroom accountant-client privilege
in their accountancy laws. See Smith S.G., 'Privileged Communications, Independence, and
Client Advocacy: A Perspective on Professionalism.' (1990) 9, (2) *Journal of Accounting & Public
Policy* 135-157 at 142.
90 465 US (1984).
91 *Id* at 817-8 per Burger CJ
92 104 S. Ct. 1495, (1984)
93 Anderson, M., Anderson, U., Helleloid, R., Joyce, E., & Schadewald, M., 'Internal Revenue
Service Access to Tax Accrual Workpapers: A Laboratory Investigation.' (1990) V 65, No 4 *The
Accounting Review* 857 at 862.
94 Note: The English Law Reform Committee in the 16th Report, *Privilege in Civil Proceedings*
(1967) Cmnd. 3472 stated the rational for confining legal professional privilege to lawyers is
that advice given by a lawyer is concerned exclusively with rights and liabilities enforceable in
law.