Analysis

You can *Reid* all about it (because it's not privileged)

Speed read

The High Court decided in *Reid* that a solicitor's advice to his clients was not privileged as it related to the establishment of a tax avoidance scheme where there was a prima facie case that the solicitor knew the scheme did not work, even if his clients did not. This suggests that the High Court has extended the law on third party iniquity beyond that already recognised, which will impact other mass-marketed tax avoidance schemes. It is the first tax case involving the iniquity principle, as well as forming a beachhead in HMRC's use of their criminal powers.

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'There is no equity about a tax,' Rowlett J once said. But in 2025 the High Court may have found, for the first time, an iniquity in trying to avoid one.

The iniquity principle is a rule which prevents legal professional privilege from arising over communications or documents that were prepared in furtherance of a criminal or fraudulent purpose. *Reid v HMRC* [2025] EWCR 4 is, to the authors' knowledge, the first case which has applied this principle in relation to tax advice. It also appears to be the first time in at least recent memory in which HMRC has brought a charge of conspiracy to cheat the public revenue not for misleading them as to the factual position but for taking a legal position HMRC alleges to have been knowingly incorrect.

Mr Reid's advice and HMRC's investigation

As is well known, the loan charge was introduced to remove the tax benefit of historic disguised remuneration (DR) planning. Relevant schemes relied on employee loans made by employee benefit trusts (EBTs) being left outstanding indefinitely; the loan charge worked by deeming any loan outstanding on 5 April 2019 to be a 'relevant step' for the purposes of the DR rules in ITEPA 2003 Part 7A. If the other conditions for the DR rules were met, the outstanding balance was brought into charge as employment income.

There was what the High Court called an 'obvious financial incentive' for those who faced an impending loan charge to extinguish the loan balance before 5 April 2019. Mr Reid, a solicitor at a firm called Reid & Co, identified this, and marketed a scheme to enable employees to repay the DR loan prior to 5 April 2019. Under the scheme, affected employees would pay a fee, which would be used (in part) to subscribe for shares in a new company, Pyrrhus Capital Ltd ('Pyrrhus'). Pyrrhus would loan the subscription monies to some of the participating employees to repay their DR loans. The trustee of the relevant EBT would then reinvest the money in shares in Pyrrhus, which would re-loan the money to a new set of participating employees. Once all of the DR loans were repaid, Pyrrhus would be 99% owned by the trustees, who would then appoint their shares to the participating employees, closing the loop.

As part of an investigation into whether this scheme might constitute a criminal offence, HMRC seized documents from Reid & Co's offices in February 2020. HMRC is not entitled to retain privileged documents; it issued a notice to Mr Reid that in the absence of any application to the contrary, it planned to disclose all documents to the investigating team. On 25 February 2024, one day ahead of the deadline given by HMRC, Mr Reid made an application under the Criminal Justice and Police Act 2001 s 59(2) for the court to order HMRC to return certain documents, on the basis that they were subject to legal privilege.

On 20 May 2024, Mr Reid, among others, was charged with conspiracy to cheat HMRC of public revenue. HMRC resisted the application to return the documents on the basis that the iniquity principle applied.

The court's approach to the iniquity principle

The iniquity principle was characterised in *Follett v Jefferyes* (1850) 61 ER 1 in this way:

> 'It is not accurate to speak of cases of fraud contrived by the client and solicitor in concert together, as cases of exception to the general rule. They are cases not coming within the rule itself; for the rule does not apply to all which passes between a client and his solicitor, but only to what passes between them in professional confidence, and no Court can permit it to be said that the contriving of a fraud can form part of the professional occupation of an attorney or solicitor.'

In other words, advice on the commission of a crime or fraud is not privileged in the first place. This puts the court in a difficult position. HMRC would like access to the documents in the hope of proving their allegations against Mr Reid – but they can only have them if they can establish they were created in furtherance of the very offence they are seeking to prove. In the words of Stephen J in *R v Cox and another* (1884) 14 QBD 153: 'The privilege must ... be violated in order to ascertain whether it exists. The secret must be told in order to see whether it ought to be kept'.

This chicken-and-egg problem is solved by the court first evaluating whether there is a *prima facie* case of fraud; in *Al Sadeq v Dechert LLP* [2024] EWCA Civ 28 the Court of Appeal decided this was a balance of probabilities test: was it more likely than not, on the evidence before the court, that there was a fraud, crime, or other iniquity?

The High Court here found that there was. Because there is a pending criminal trial, many of the findings of the court are contained in a confidential annex, which will not be publicised until after the criminal trial has concluded. That trial is scheduled to commence on 1 March 2027.

The court said that it was not necessary to decide

whether the taxpayers had themselves intentionally filed incorrect returns. Since the alleged victim was HMRC, rather than the taxpayers, a fraud could be made out even if Mr Reid had misled the taxpayers into filing false tax returns unknowingly. As a result, the court said, it could determine whether privilege had been lost on the same basis.

The court then considered whether the scheme worked, and concluded that it did not. That is the end of the public-facing part of the judgment. The rest, presumably covering the knowledge and intention of Mr Reid when he was promoting the scheme, is contained in the confidential annex.

Does the client have to know about the iniquity?

The quote from *Follett* above uses the example of a fraud conspired between client and lawyer. That is a classic example of the iniquity principle applying to deny privilege; both the lawyer and the client know that the communication is not part of the usual professional role of the lawyer.

It is also clear that the lawyer does not need to know about the iniquity. In *Cox*, Stephen J said that for privilege to 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'. If the lawyer is aware of the fraud intended by her client, then they are within the *Follett* example and outside the professional employment of a lawyer. If the lawyer has been deceived by her client, then there is no confidentiality. In either case there is no privilege.

In the meantime, it seems likely that barristers and solicitors who give opinions on avoidance schemes which they consider to be less than likely to be successful may well lose claims of privilege and have that advice disclosed to HMRC, irrespective of whether the lawyer or the client is the promoter

What if the client is innocent? It is now settled law that privilege in legal communications is a fundamental human right, and it is the client's right, not the lawyer's. Can a client's right really be voided by her lawyer's motive? As noted above, in *Reid* the court decided that it did not need to establish whether the taxpayers had knowingly filled out their tax returns incorrectly. That is clearly correct in relation to the offence of conspiracy to cheat the public revenue: there does not need to be actual cheating established for the conspiracy charge to stick. But is a cheating motive on behalf of the client taxpayers essential for them to lose their privilege?

The House of Lords in *R v Central Criminal Court ex parte Francis & Francis* [1989] AC 346 held for the first time that the iniquity exception could apply where the client was an 'innocent tool' of a third party, though said this would only happen in a type of case that was 'most exceptional' in recognition of the effect it has on the curtailing of the innocent client's legal rights. In *Accident Exchange v McLean* [2018] 4 WLR 26, Sir Andrew Smith declined to extend third party iniquity further than this, saying:

> '[I]n the cases in which third party iniquity has deprived an innocent client of the protection of privilege, the wrongdoer and the client have had a relationship (or nexus) separate from the dealings with a solicitor, and that separate relationship was used by the wrongdoer to advance the wrongdoing. In my judgment, such connections between client and wrongdoer and between their relationship and the iniquity will be a hallmark of cases where an innocent client loses the protection of privilege. They might not be absolute requirements in all such cases, but I find it difficult to envisage a case in which they would not be present.'

Where does this leave Mr Reid? If his client taxpayers are not guilty of cheating the public revenue or some other iniquity, why has the High Court found their privilege did not arise?

It may be that this is an extension to the principle in *Francis & Francis*, whereby it is Mr Reid's iniquitous purpose as solicitor, not a third party's, that has deprived his clients of their privilege. Since the court has found a *prima facie* case of conspiracy to cheat the revenue, we must assume that it found that Mr Reid approached his clients with the intention that they submit false tax returns, with the intended result that the public purse is deprived of tax revenue, his clients save some tax, and he is rewarded with fee income. His clients, from this perspective, would be 'innocent tools' of Mr Reid's tax avoidance scheme, and would unfortunately have their privilege abrogated even if innocently seeking legal advice.

The public-facing version of the judgment does not expressly adopt this approach, and so we do not know whether this is the court's reasoning for its conclusion that the documents were not privileged. But it sits uneasily with the suggestion in *Accident Exchange* that the wrongdoing and the solicitor–client relationship must be separate for the iniquity to negate the client's privilege.

Alternatively, the argument could be run that Mr Reid was not acting in his capacity as a solicitor when he was marketing a tax scheme he allegedly knew did not work. If, as Lord Cranworth VC said in *Follett*, the rationale for the iniquity principle is that 'the contriving of a fraud' is not part of the professional occupation of a lawyer, that may hold true even when the client is approaching the lawyer in good faith. But that again appears to be an extension of the *Francis & Francis* principle unarticulated in the open part of the *Reid* judgment, and, depending on one's view of the state of the tax avoidance industry, may not agree with the dictum of the House of Lords in that case that third party iniquity would only be in the 'most exceptional' cases.

Given the importance of the *Reid* decision to Mr Reid personally as well as the fact that this appears to be the first time that the iniquity exception has been applied to an allegedly wrongdoing lawyer with *ex hypothesi* innocent clients, an appeal appears likely.

Breadth of iniquity principle in tax cases

Mr Reid has been indicted for conspiracy to cheat the public revenue (and the High Court has found a *prima facie* case has been made out). This is a crime, clearly a class of iniquity which engages the privilege exception. Fraud (even civil fraud) is the other classic example.

What, short of legal advice taken to further crime and fraud, engages the iniquity principle? A run of cases has applied the exception to conduct variously described as 'commercial dishonesty of the very worst kind', 'trickery and sham contrivances', and, at the high-water mark in *Barclays Bank plc v Eustice* [1995] 1 WLR 1238, 'sharp practice'.

Eustice involved the Insolvency Act 1986 s 423, entitled 'transactions defrauding creditors', which allows the court

to set aside transactions made at an undervalue for the purposes of defrauding creditors. The Court of Appeal undertook a balancing of the public interests, and found that given the clear intention of Mr Eustice to come up with a means to prejudice his creditors by undertaking a transaction at undervalue, the legal advice he had taken to effect this was not privileged, despite not finding that Mr Eustice had committed common law fraud.

Other bases for invoking the iniquity principle over something other than an explicit finding of crime or fraud include agents breaching a duty of fidelity to their principal (*BBGP Managing General Partner Ltd v Babcock & Brown Global Partners* [2010] EWHC 2176), a borrower mispresenting facts to procure an advance from a lender (*Nationwide Building Society v Various Solicitors* [1998] 1 WLUK 248), deliberate and concealed breach of the Companies Act 2006 to deny a shareholder his shareholding (*Barrowfen Properties v Patel* [2020] EWHC 2536), a disposition of matrimonial property to defeat a spouse's claim on that property on divorce (*C v C (Privilege)* [2006] EWHC 336 (Fam)), and concealment of a bankrupt's assets (*Williams v Mohammed* [2011] EWHC 3293 (Ch)).

In some ways this shift in approach is a welcome development. An HMRC criminal enforcement strategy which focuses clearly on whether advice was given in bad faith or on fraudulent or misleading terms might finally have a real dissuasive impact on a hithertofore persistent tax avoidance industry

Whilst there have been, to the authors' knowledge, no cases other than *Reid* on the application of the iniquity principle to tax advice, HMRC has indicated an awareness of the possibilities. In its recent consultation entitled *Closing in on promoters of marketed tax avoidance*, HMRC noted that advice on tax avoidance schemes may not be privileged 'due to the iniquity exception', though it characterised the principle as applying to 'crime, fraud or equivalent conduct'.

How far the decision in *Eustice* can be taken remains uncertain. Until there is further clarity on what is meant by 'sharp practice', it is difficult to say whether conduct short of cheating the public revenue, or a tax evasion offence, would suffice to invoke the iniquity principle. Tax avoidance cases often involve suggestions that the structure chosen is circular, contrived, or contrary to the purpose of the legislation. Does that in itself count as 'sharp practice'? Does the level of artifice matter? Does it matter whether Parliament would have intended the result? Prominent textbooks have for some time been calling for Supreme Court clarification of the position post-*Eustice*; the Court of Appeal has been asked to revisit *Eustice*, the High Court has said it 'might be open to question', and Lord Neuberger has said he would 'leave open the question of whether [it] was rightly decided'. Clarity would most certainly be welcome, particularly in relation to *Eustice's* interaction with the tax avoidance/evasion distinction.

In the meantime, it seems likely that barristers and solicitors who give opinions on avoidance schemes which they consider to be less than likely to be successful may well lose claims of privilege and have that advice disclosed to HMRC, irrespective of whether the lawyer or the client is the promoter. It seems also possible that self-serving assumptions that are plainly not correct, even if the legal advice contingent on those assumptions is, will not suffice to allow a barrister to cloak herself in privilege.

Are more tax advisers at risk of prosecution?

It may be premature to make observations about a part of the case which will not be properly tried for another year and a half. It is important to remember that HMRC have only succeeded on a *prima facie* balance of probabilities case at first instance, and may either lose on appeal of this decision or fail to surmount the higher criminal standard of proof on the substantive case.

Nevertheless, in bringing the charges they have against Mr Reid, HMRC appear to be signalling a change in approach.

The cases in which either the inchoate offence of conspiracy to cheat the public revenue or the primary offence of cheating the public revenue have been made out in the recent past have been blatant cases of fraud by deliberately deceiving HMRC as to the true facts. See, for example, *Dosanjh* [2013] EWCA Crim 2366, missing trader intra-community VAT fraud; *Charlton and others* [1996] STC 1418, which involved invoice inflation; *Dimsey* [2001] UKHL 46, hiding a company's UK residence; *Mavji* [1986] STC 508, where the taxpayer intentionally failed to pay VAT; *Hunt* [1994] STC 819, import fraud; and *Stannard* [2005] EWCA Crim 2717, falsifying expenses on which deductions were taken.

Even assuming Mr Reid were convicted of the offence he has been accused of, his conduct is of a qualitatively different nature to those canvassed above. He is not alleged to have falsified, or advised his clients to falsify, facts. It is not alleged that the transactions that he advised on were shams. Instead, it is said that the advice he gave was wrong, and that he knew it was wrong when giving it.

Reputable advisers should not, the authors would hope, be concerned by this more expansive approach taken by HMRC. Whilst we do not yet have the confidential annex, or the criminal judgment, most advisors are unlikely in the extreme to meet the dishonesty threshold crucial for a conspiracy to cheat charge to be made out. Indeed, the authors and other advisers have exhorted HMRC to use more effectively its existing powers to tackle evasion and aggressive avoidance. The various public responses by industry bodies to the 'closing in on promoters' considerations echo this.

Thus, in some ways this shift in approach is a welcome development. An HMRC criminal enforcement strategy which focuses clearly on whether advice was given in bad faith or on fraudulent or misleading terms might finally have a real dissuasive impact on a hithertofore persistent tax avoidance industry. Nevertheless, HMRC will need to be able to prove that the promoter is dishonest; a mistaken, even idiosyncratic view of the law will not suffice if the promoter is acting honestly. That evidential hurdle is not always easy to surmount. ■

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